

Estate Planning in 2020

January 14, 2020

We anticipate that, for higher-net-worth individuals, much of estate planning in 2020 will be focused on continuing to take advantage of the current \$11.58 million (\$23.16 million combined for a married couple) federal estate, gift and generation-skipping transfer (GST) tax exemptions, while they are still available.

As discussed below, for certain individuals, revisiting beneficiary designations for IRAs, 401(k)s and other qualified plans will be important in light of the recent enactment of the SECURE Act.

Those who have previously exhausted their exemptions might “top up” existing structures in 2020, and in future years, as additional inflation adjustments are made to the relevant exemption amounts.

In the current low interest rate environment, strategies involving grantor retained and charitable lead annuity trusts (so-called “GRATs” and “CLATs”) are also likely to continue to be of interest to high-net-worth individuals.

A summary of certain related matters is included below.

Federal Transfer Tax Developments

Increased Federal Transfer Tax Exemptions

The Tax Cuts and Jobs Act (the “Act”), which took effect January 1, 2018, made sweeping changes to the federal tax landscape. Of particular relevance in the estate planning context were significant increases to the federal estate, gift and GST tax exemption amounts. While those increases are currently scheduled to be in effect through the end of 2025 (after which the exemption amounts are scheduled to revert to their pre-2018 \$5 million plus relevant inflation adjustment amounts), a number of 2020 Democratic presidential candidates have proposed to rescind the increase in the exemption amounts and potentially increase the relevant tax rates.

For example, Senator Sanders (I-VT) has proposed an increase in the marginal estate tax rates from the current 40%, to marginal rates starting at 45% on estates valued in excess of \$3.5 million, with a top marginal rate of 77%.

In addition, Senator Warren (D-MA) has proposed a wealth tax on households ranging from 2% to 6% on an annual basis (on assets over \$50 million). While there are significant questions regarding the constitutionality of a wealth tax, the tax is receiving significant attention in the media and among the other Democratic candidates, and may impact future debates over the estate tax (which is effectively a wealth tax imposed at death).

Senators Romney (R-UT) and Bennett (D-CO) have also introduced bi-partisan legislation that would significantly limit the “step up in basis” received by assets includable in a decedent’s estate. Such a limitation would effectively increase the capital gains taxes ultimately payable upon the sale of assets inherited from large estates.

In this context, it may be particularly compelling to make lifetime gifts in 2020 to take advantage of the Act’s increased exemption amounts while they are still available.

Those concerned with their own financial security in the context of additional lifetime giving might consider including a spouse as a beneficiary of a “SLAT” (spousal lifetime access trust) or exploring the creation of a “self-settled asset protection trust” in a jurisdiction, such as Delaware, which permits such a trust.

In the case of trustees and beneficiaries of discretionary trusts, particularly trusts that will be subject to GST tax in the future or are scheduled to terminate in the near-term, consideration could be given to making distributions to beneficiaries to enable them to make full use of their own exemptions while still available.

Beneficiary Designations Following the SECURE Act

On December 20, 2019, President Trump signed into law the Setting Every Community Up for Retirement Enhancement Act, also known as the “SECURE Act.” While the SECURE Act includes provisions relating to retirement plans that may be helpful to account owners seeking to delay taking required minimum distributions (RMDs) from IRAs, 401(k)s and other qualified plans during their lifetimes (as well as allowing additional time for making contributions to such plans), following the death of an account owner, the SECURE Act significantly curtails the ability of the designated beneficiary of the account to draw down the account balance over his or her lifetime.

Prior to the enactment of the SECURE Act, account owners could leave their IRAs, 401(k)s and other qualified plans to beneficiaries on death, who would then be able to take RMDs over their own lifetimes in order to allow the retirement accounts to continue to grow on a tax-deferred basis (i.e., allowing the beneficiaries to “stretch” such distributions over a longer period of time). Under the SECURE Act, however, most beneficiaries who were previously eligible for stretch treatment generally will be required to draw down the accounts by the end of the 10th calendar year following the account owner’s death.

Exceptions to the new 10-year rule are made for beneficiaries who are spouses, minor children (with the 10-year drawdown period tolled until a child reaches the age of majority), disabled or chronically-ill, or not more than 10 years younger than the account owner.

As under prior law, designating an owner’s estate, or a trust that does not fit within particular exceptions, as a beneficiary can result in a maximum 5-year payout.

In this context, we are recommending that clients with significant retirement accounts, particularly clients who have named trusts as primary or contingent beneficiaries of such retirement accounts, review the related beneficiary designations for purposes of determining whether any changes should be made.

2020 Annual Exclusion Gifts

The 2020 gift tax annual exclusion amount will remain unchanged from 2019, at \$15,000 per donee.¹

For gifts by a U.S. citizen or domiciliary to his or her non-U.S. citizen spouse, the available annual exclusion amount increased from \$155,000 to \$157,000 in 2020.²

Individuals already planning to make an annual exclusion gift to an account for a minor may wish to consider a 529 Plan. Under the Act, 529 Plan account owners enjoy income tax-free distributions not only for qualified higher education expenses, as was permitted under prior law, but now also for up to \$10,000 per year for elementary and secondary school tuition and expenses. In addition, under the SECURE Act, 529 Plan account owners may now use up to \$10,000 towards qualified education loans. Some states, such as New York, however, do not conform to the new federal rules under the SECURE Act, and require

¹ Spouses may elect to split gifts and claim a combined exclusion of \$30,000 with respect to a particular donee, even if one spouse funds more than half of that combined exclusion in respect of the same donee.

² There is a larger annual exclusion for such gifts because, unlike gifts to a U.S. citizen spouse, gifts to a non-U.S. citizen spouse that exceed the annual exclusion do not qualify for the unlimited gift tax marital deduction.

the recapture of state-level tax benefits if distributions are made for elementary or secondary school tuition and expenses, as well as distributions used for student loans.

Direct Payment of Tuition and Certain Medical Expenses

Direct payments to the relevant service provider of certain qualified tuition and medical expenses on behalf of the individual receiving the related goods and services will continue to be exempt from gift tax.

State Transfer Tax Developments

Included below is a summary overview of the current New York, Connecticut and New Jersey transfer tax regimes. By way of comparison, Florida does not impose any state level income, estate or inheritance taxes.

New York

The New York estate tax exemption equivalent increased from \$5.74 million to \$5.85 million effective January 1, 2020, but continues to be phased out for New York taxable estates valued between 100% and 105% of the exemption amount, with no exemption being available for taxable estates in excess of 105% of the exemption amount.

Although the top New York estate tax rate continues to be 16% for estates over \$10.1 million, the effective rate can be lower due to the continued deductibility for federal estate tax purposes of any New York estate tax paid. However, estates that are no longer subject to federal estate tax by reason of the increased federal exemption will no longer benefit from the deduction, resulting in a higher effective rate for New York estate tax purposes.

There is currently no New York gift or GST tax, but special estate tax rules apply to certain gifts of property made within three years of death.

Connecticut

The Connecticut estate and gift tax exemption amounts increased to \$5.1 million effective January 1, 2020.

In 2018, Connecticut enacted new legislation that extended the timeline for increases in the Connecticut gift and estate tax exemption amounts. Under this legislation, the Connecticut gift and estate tax exemption amounts are scheduled to increase to \$7.1 million on January 1, 2021 and \$9.1 million on January 1, 2022. Starting January 1, 2023, the Connecticut exemption amounts are expected to match the federal estate and gift tax exemption amounts (approximately \$11.58 million, plus the additional federal inflation adjustment relevant for 2023).

On January 1, 2020, the Connecticut estate and gift tax rates increased and now range from 10% (for estates and gifts exceeding the \$5.1 million exemption amount) to 12% (for estates and gifts exceeding \$10.1 million). As the Connecticut exemption amounts increase, the lower end of this rate range will increase correspondingly, to eventually reach 12% on all taxable estates in 2023 and thereafter. The Connecticut gift and estate tax is now capped at \$15 million, down from \$20 million in 2018. Estate taxes paid to Connecticut may be deducted for federal estate tax purposes (to the extent a federal estate tax would otherwise be payable), but there is no corresponding federal gift tax deduction. Moreover, estates that are no longer subject to federal estate tax by reason of the increased federal exemption will no longer benefit from the deduction, resulting in a higher effective rate for Connecticut estate tax purposes.

Connecticut remains the only state in the nation that imposes a gift tax, with a \$15,000 gift tax annual exclusion. Connecticut does not impose a GST tax.

New Jersey

The New Jersey estate tax was repealed effective January 1, 2018.

New Jersey has, however, retained its separate inheritance tax, which does not generally apply to transfers to a spouse, civil union or domestic partner, child or grandchild and certain other close family members. The New Jersey inheritance tax rates depend on the amount received and the relationship between the decedent and the beneficiary receiving assets from the decedent. Under the inheritance tax, transfers to siblings are generally taxed at a rate beginning at 11% (top rate is 16%) and transfers to others are taxed at a rate of 15% or 16%. New Jersey inheritance tax is also deductible for federal estate tax purposes, to the extent a federal estate tax would otherwise be payable. There is currently no New Jersey gift or GST tax.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

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