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Dear Clients and Friends:

The future of the federal estate and gift taxes is now more certain than it has been for a decade. The American Taxpayer Relief Act of 2012 established a “permanent” exemption of \$5,000,000 (indexed for inflation after 2011) and a “permanent” flat tax rate of 40% on all taxable transfers above the exemption amount.

While the American Taxpayer Relief Act received much media attention, other developments during 2013 had important effects and opened significant new avenues for estate planning.

### **Inflation-Adjusted Transfer Tax Exemptions**

The inflation-adjusted 2014 exemptions for the federal estate, gift and generation-skipping transfer taxes are \$5,340,000, an increase of \$90,000 from the 2012 exemption level, while the expanded annual exclusion for gifts to a non-citizen spouse has increased from \$143,000 to \$145,000 in 2014. The 2014 limit for conventional “annual exclusion gifts” remains at \$14,000 per donee, or \$28,000 per donee for a married couple.

### **Reasons to Accelerate Timing of Gifts**

The new “permanency” of the federal transfer tax laws should not deter anyone whose estate might be subject to the federal estate tax (or even just state estate tax) from starting or continuing a gifting program to reduce taxes. Gifts work best over time, since they tend to shift more income and appreciation as time goes by.

Furthermore, certain gift techniques are most effectively employed in a low interest rate environment. They include grantor retained annuity trusts (or “GRATs”) and intra-family loans. Although interest rates remain relatively low, a key interest rate used by the IRS for gift valuations increased by one percent (1%) during 2013. Clients who believe interest rates will continue to rise should therefore consider utilizing these techniques sooner rather than later.

For New York residents, one advantage of lifetime gifting is the absence of a gift tax at the state level. The recently released New York State budget bill would, however, amend the New York estate tax statute so that “taxable gifts” made on and after April 1, 2014, would increase a New York resident’s state estate tax liability. New York residents

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who are contemplating large gifts in 2014 or shortly thereafter should therefore consider completing their transfers before this date.

### **Income Tax Planning for Estates and Trusts**

In 2013, individuals, estates and certain trusts became subject to the Affordable Care Act's 3.8% tax (the "ACA tax") on investment income above a threshold amount. For estates and trusts, this threshold amount is only \$11,950 of taxable income in 2013 and \$12,150 of taxable income in 2014. By comparison, this threshold for individuals is \$200,000 for single filers and \$250,000 for joint filers.

The low ACA tax threshold applicable to trusts increases the incentive for trustees to distribute trust income to beneficiaries, since doing so can reduce or eliminate the ACA tax. Distributions that reduce trust taxable income below the ACA tax threshold will also reduce the trust's capital gains tax rate from 20% to 15%. A special rule in the tax code gives trustees 65 days after the close of the tax year (March 6, 2014, in the case of the 2013 tax year) to determine a trust's potential tax liability and make distributions if necessary.

### **New York Estate Tax Relief for Some Non-U.S. Citizen Spouses**

Generally speaking, the unlimited marital deduction exempts all bequests to the surviving spouse from the federal estate tax. If the surviving spouse is not a U.S. citizen, however, the marital deduction applies only if the bequest is made to a "qualified domestic trust" (commonly referred to as a "QDOT") for the surviving spouse. This requirement adds complexity to the couple's Wills and to trust administration.

In 2013, New York amended its estate tax law to eliminate the QDOT requirement for estates too small to need a federal estate tax return (*e.g.*, estates under \$5,340,000 in 2014). Clients whose Wills included a QDOT for the surviving spouse solely to generate a New York estate tax marital deduction can now amend their Wills to leave the surviving spouse's share outright.

### **Planning Opportunities for Married Same-Sex Couples**

In *Windsor v. United States*, the Supreme Court struck down the portion of the Defense of Marriage Act that defined "marriage" as exclusively a union between a man and a woman. Following the *Windsor* decision, the IRS issued Revenue Ruling 2013-17, which announced that a same-sex marriage will be recognized for federal tax purposes if the marriage was valid in the state or country where it was performed, even if the couple lives in a state that does not recognize same-sex marriages. It is worth noting that these developments relate only to "marriages" and do not necessarily extend to other forms of union under state law, such as civil unions and domestic partnerships.

In light of these changes, a married same-sex couple should ensure the continued appropriateness of their estate plan as follows:

- *Review estate planning documents.* The couple's Wills should be updated with an eye toward possible use of the marital deduction and "portability of exemptions" between spouses.
- *Consider amending previously filed federal estate and gift tax returns.* A previously filed gift or estate tax return may be amended to claim retroactively the marital deduction and/or the deceased spouse's unused exemption under the portability rules. Generally, such amended returns must be filed within three years from date the original return was filed.
- *Review titling of assets.* Smart planning for all married couples often includes titling assets so that both spouses' exemptions from tax are fully utilized. The gift tax marital deduction now available to a married same-sex couple makes this process easier, since most transfers between spouses do not carry gift tax consequences.
- *Review retirement account beneficiary designations.* The same-sex spouse of a participant in a retirement plan covered by ERISA (e.g., a 401(k) plan, but not an IRA) will now automatically be the primary beneficiary of the retirement plan and must now consent to the participant's naming someone else as beneficiary.
- *Consider making split gifts in 2014 or beyond.* A married same-sex couple may now utilize the "gift splitting" election, which treats all gifts made during a year as coming equally from each spouse, no matter which spouse was the actual source of the gifted property.

### **The New Connecticut Probate Court Rules**

The Connecticut probate court system instituted new procedural rules that took effect on July 1, 2013. Perhaps the most significant effect of these new rules is the increased exposure of one's personal financial affairs after death. For example, a remote relative or a charity that receives a small cash bequest under the Will now must receive a copy of the testator's estate tax return and accounting, which disclose the size and disposition of the entire estate. Our Connecticut clients who desire more privacy in the settlement of their affairs use revocable trusts to minimize probate court involvement. Titling assets in the name of a revocable trust during life removes those assets from probate court supervision for nearly all purposes.

## **Charitable Planning and the New York Non-Profit Revitalization Act of 2013**

The New York Non-Profit Revitalization Act of 2013, which was designed to reduce burdens on the nonprofit sector while strengthening governance and accountability, overhauled requirements in New York State with respect to nonprofit corporations and charitable trusts. Many of the provisions of the Act take effect on July 1, 2014. The policies and procedures of New York nonprofit corporations and wholly charitable trusts should be reviewed promptly to ensure compliance with the new requirements.

### **Looking Ahead: Possible New York Estate Tax Reform**

Last December, the New York State Tax Relief Commission issued a report which advocated raising the New York estate tax exemption to \$5,250,000, with annual inflation adjustments. It also recommended that the top New York estate tax rate be lowered from the current 16% to 10%. According to the report, these changes would exempt nearly 90% of all New York resident estates from the state estate tax.

Governor Cuomo's budget bill released on January 21, 2014, incorporated these proposals. Under the bill, the state estate tax relief would be phased in over four years, with the inflation adjustments to the exemption level using 2018 as the base year. These changes would take effect for decedents dying on and after April 1, 2014.

These developments will suggest opportunities for additional planning to some and opportunities for simplification of their plans to others. As always, your DD&C attorney will be glad to discuss how these developments apply to you, and how they might be used to your advantage in your estate plan.

Sincerely,

DAVIDSON, DAWSON & CLARK LLP

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