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Dear Clients and Friends:

As life and work slowly return to pre-pandemic norms, we are pleased to resume our practice of informing you of recent developments that affect estate planning.

### **Federal Estate, Gift and GST Tax Provisions**

It is notable that no legislation was enacted in 2021 to reduce the amount of the federal estate, gift and generation-skipping transfer (“GST”) tax exemptions (collectively, the “federal exemption amount”) or to eliminate the “stepped up basis” for assets inherited from a decedent, both of which had been points of concern in prominent 2021 tax bill proposals. Currently there are no rumored tax law changes for 2022, so taxpayers may breathe a temporary sigh of relief.

The annual inflation adjustments increased the federal exemption amount to \$12,060,000 for 2022. The gift tax annual exclusion has increased to \$16,000 per donee – or \$32,000 per donee for married couples who elect to split gifts. The annual exclusion for gifts to a non-U.S. citizen spouse has increased to \$164,000.

### **Make Gifts Within the Expanded Federal Exemption Amount**

The present federal exemption amount represents a \$10 million “basic exclusion” with inflation adjustments dating back to 2011. In the absence of further legislation, on January 1, 2026 the basic exclusion will revert to \$5 million, though still adjusted for inflation. In effect, the 2026 federal exemption amount will be roughly half of the 2025 federal exemption amount.

Clients with sufficiently large estates may consider utilizing their currently expanded federal exemption amounts by making large gifts prior to 2026. The IRS has clarified that any tax savings achieved through such gifts will not be recaptured (or “clawed back”) after 2025. To benefit from the expanded exemption before it expires, the donor’s pre-2026 gifts must exceed 50% of the expanded federal exemption amount.

### **Strategies for a Low Interest Rate Environment**

Interest rates from 2010 through 2021 had remained at historic lows. However, as we have seen so far in 2022, interest rates are beginning to rise. Below are a few examples of

strategies for transferring wealth from a more senior generation to a younger generation while interest rates are low:

- Intrafamily-loan: Parent lends cash to her child. If the loan proceeds invested by the child appreciate more than the interest rate paid on the loan, the excess appreciation passes to the child-borrower free of gift tax.
- Installment Sale to an Intentionally Defective Grantor Trust (IDGT): Parent creates a “grantor trust” (*i.e.*, a trust with terms that make the grantor responsible for paying the trust’s income tax bill). Parent sells assets to the trust in exchange for a promissory note bearing interest at the lowest IRS-authorized rate. Any appreciation on the assets sold to the grantor trust in excess of the interest on the promissory note passes to the trust’s beneficiaries free of gift tax.
- Grantor Retained Annuity Trust (GRAT): Parent transfers assets to a trust (a “GRAT”) in exchange for an annuity paid to Parent for a term of years. The gift tax value of the transfer is the value of the assets contributed to the GRAT, less the present value of Parent’s annuity. If Parent is alive when the last annuity payment is made, the remaining assets in the GRAT pass to Parent’s children and, if the GRAT’s assets appreciate at a rate greater than the IRS interest rate, the excess appreciation passes free of estate and gift tax.

As interest rates rise, certain strategies capitalize on higher interest rates to reduce the actuarial value of a taxable gift or to gain other tax advantages. Below are examples of such strategies:

- Qualified Personal Residence Trust (QPRT): Parent transfers his primary or vacation residence to a trust (a “QPRT”) and retains the rent-free use of the residence for a term of years. The gift tax value of the transfer is the fair market value of the residence, less the present value of Parent’s retained use (measured by the IRS-determined market rate of interest for the month of transfer). The greater the IRS-determined interest rate, the lower the gift tax value of the transfer.
- Charitable Remainder Annuity Trust (CRAT): A CRAT is a trust that pays an annuity to the grantor for a terms of years, with the value of the remainder interest passing to charity generating an income tax charitable deduction. The greater the IRS-determined interest rate, the greater the value of the remainder and charitable deduction.

### **New York Estate Tax Developments**

New York’s estate tax exemption has increased to \$6,110,000 for deaths that occur in 2022.

Make Large Gifts Now. Although New York’s marginal estate tax rate (16%) is substantially less than the 40% federal rate, the tax can be a significant consideration for estates which are greater than New York’s exemption but not the federal exemption. This is particularly true because the New York exemption phases out rapidly once the estate exceeds it in value (commonly referred to as New York’s “estate tax cliff”).

You can make gifts up to the federal estate and gift exemption amount before any federal gift tax is owed. In 2022, for an individual with a taxable estate that is less than the \$12,060,000 federal exemption amount but more than the \$6,110,000 New York estate tax exemption amount, making a large gift now may eliminate New York estate tax at death. For example, if you have a \$7,000,000 estate, and you make a \$2,000,000 gift today, as long as you survive for 3 years after the date of your gift, at your death your \$2,000,000 gift will not be counted as part of your New York taxable estate, and (under current law) there will be no New York estate tax due on your remaining \$5,000,000 estate.<sup>1</sup>

### **Other New York Developments**

Important New York legislation which passed or became effective in 2021 includes:

- The Child-Parent Security Act which legally established a child's relationship to his or her parents in cases where the child is conceived through assisted reproduction.
- The New York Statutory Short Form Power of Attorney which was simplified to reduce the frequency of refusal by financial institutions to honor validly executed Powers of Attorney. It also makes the authorization of gifts by the agent on behalf of the principal less cumbersome.
- Electronic notarization of documents, permitting the use of audio-video conferencing technology becomes effective June 20, 2022. The new law does not, however, address the remote witnessing of Wills (which was permitted earlier during the pandemic but is no longer authorized under New York law).

### **Connecticut Estate and Gift Tax Developments**

The Connecticut estate and gift exemption is \$9,100,000 for 2022, and it is currently scheduled to equal the federal exemption amount in 2023 and future years. That means the Connecticut exemption amount will be subject to the same inflation adjustments as the federal exemption amount starting in 2023, but it also will be cut back in 2026 if the federal basic exclusion is reduced to \$5 million (plus the inflation adjustment) as is currently scheduled to occur.

Unlike New York State, Connecticut imposes a gift tax in conjunction with its estate tax. As a result, Connecticut residents cannot reduce their state estate tax liability through large lifetime gifts in the same way New York residents can. Furthermore, while the IRS has confirmed there will be no "claw back" under the federal estate tax if the decedent took advantage of the pre-2026 expanded federal exemption amount with gifts, Connecticut's Department of Revenue Services has yet to give Connecticut taxpayers similar assurances.

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<sup>1</sup> New York does not impose a state gift tax, but does have a "clawback" rule that provides that lifetime gifts made within 3 years of death are clawed back into an individual's estate for purposes of determining New York estate tax.

## **Other Connecticut Developments**

The Connecticut Uniform Trust Code (the “CUTC”), which became effective on January 1, 2020 made sweeping changes to Connecticut’s trust law. Some of the more important features of the CUTC include the following:

- For any trusts that become irrevocable after 2019, trustees are required to provide certain beneficiaries notices and annual reports with information about the trust and its assets. Trust grantors can impose some limits on the required disclosures, including through the appointment of a “designated representative” to receive required notices on behalf of the beneficiaries and by waiving annual reports absent a specific request by certain beneficiaries.
- For the first time, a Connecticut trust grantor can retain a continuing interest in an irrevocable trust without subjecting the trust to the claims of her creditors or to estate tax at her death. Many conditions and limitations apply (*e.g.*, the creditor protection does not extend to child support obligations), as one might expect.
- Several provisions of the CUTC allow trustees and beneficiaries to fix problems with otherwise irrevocable trusts. Some fixes include amending the trust terms (*e.g.*, to correct an obvious drafting error), or even terminating a trust early (*e.g.*, to save expenses when the trust is no longer needed to carry out the grantor’s intentions).
- The limit on the duration of a Connecticut trust was increased from roughly 100 years to 800 years, providing extended opportunities for multi-generational wealth planning.

Connecticut residents who signed revocable trusts or Wills that include testamentary trusts prior to 2020 may want to have their trusts or Wills updated to include provisions that address the changes made by the CUTC. Trustees and beneficiaries of existing irrevocable Connecticut trusts may also seek advice on whether changes can be made those trusts if the terms of the trusts no longer serve intended purposes due to changes in the beneficiaries’ circumstances or to relevant tax laws.

## **Conclusion**

Changes in the law will present both challenges and opportunities in structuring wealth transfers and allocating income among individuals and entities in tax-advantaged ways. The professionals at the Firm look forward to opportunities to address your questions about this letter, other recent developments and estate planning strategies.

Sincerely,

DAVIDSON, DAWSON & CLARK LLP