DAVIDSON, DAWSON & CLARK LLP
COUNSELLORS AT LAW

60 East 42nd Street
New York, NY 10165
212.557.7700
Fax 212.286.8513
www.davidsondawson.com

Spring 2023

Dear Clients and Friends:

For this annual update of recent developments that affect estate planning, effects of the economic environment and some recent legislation about retirement accounts are among the most significant developments.

Federal Estate, Gift and GST Tax Provisions

No significant legislation was enacted in 2022 directly affecting the federal estate, gift and generation-skipping transfer ("GST") tax. More significantly, the largest annual inflation adjustments yet increased the federal exemption amounts to $12,920,000 for 2023. The gift tax annual exclusion has increased to $17,000 per donee – or $34,000 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 $175,000.

Make Gifts Within the Expanded Federal Exemption Amount

In the absence of further legislation, on January 1, 2026 the present $10 million "basic exclusion" (with inflation adjustments since 2011) reverts to $5 million adjusted for inflation, roughly half of the 2025 federal exemption amount. As this date approaches, it becomes more compelling for clients with sufficiently large estates to consider large gifts to utilize their currently expanded federal exemption amounts prior to 2026. The benefit from the expanded exemption is achieved to the extent the donor's pre-2026 gifts exceed 50% of the expanded federal exemption amount.

Retirement Accounts

Rules applicable to retirement accounts had been substantially changed by the SECURE Act in 2019, and further legislation (the "SECURE Act 2.0") and proposed regulations contain important updates for 2023.

- **During the Participant's Lifetime**: The following is a brief and general sampling of developments which generally enhance opportunities for a plan participant or IRA owner (the "participant") to defer taxation of income and to meet charitable objectives with the participant's retirement account.

18 Locust Avenue, Second Floor New Canaan, CT 06840 203.966.8759 Fax 203.966.7894

- Required Beginning Date. The age at which the participant must begin taking required minimum distributions ("RMDs") has been increased again, from 72 to 73, effective January 1, 2023, and to 75 effective January 1, 2033.
- Reduced Excise Tax on Failure to Satisfy RMD. The penalty for failure to satisfy an RMD is reduced from 50% to 25% of the shortfall and, further, to 10% if the shortfall is corrected by the end of the second calendar year after the shortfall or the commencement of an IRS audit, whichever is earlier.
- Qualified Charitable Distributions ("QCDs"). The existing rules for distributions of up to $100,000[1] per year from IRAs directly to charities, qualifying for exclusion from income, are enhanced.
  - A QCD of up to $50,000 may be made on a one-time basis to a charitable remainder trust or charitable gift annuity benefiting the participant and/or the participant's spouse.
  - Note that participants' eligibility to make QCDs remains tied to ages 70½ and older even though required beginning dates are now tied to increasing ages (currently 73, and 75 in 2033).
- Education-Related Provisions. Limited amounts from Section 529 College Savings Plans can be converted to Roth IRAs, and, starting in 2024, employers will have the option of matching an employee's student loan payments with retirement plan contributions.

- **After a Participant's Death.** Proposed Regulations provide guidance about the effect of the 2019 SECURE Act on distributions to beneficiaries, including trusts.
  - Required Minimum Distributions. A major effect of the 2019 SECURE Act was the elimination of RMDs stretched over life expectancy for designated beneficiaries other than eligible designated beneficiaries[2], changing to a requirement of distribution of the entire account over ten years. There was no mention in the 2019 SECURE Act of RMDs' being payable in each calendar year during that 10-year period, but the Proposed Regulations (assuming they are finalized) now mandate annual RMDs beginning in 2023 for all beneficiaries subject to the 10-year rule.
  - Trusts as Beneficiaries. When a trust meeting certain requirements is designated as beneficiary of a retirement account, such a "see-through" trust's beneficiaries are treated as though they are the retirement account's beneficiaries, which is desirable for RMD purposes. The Proposed Regulations provide welcome guidance that a minimal or remote interest of a trust beneficiary (such as a charity) contingent upon the death of a higher priority remainder beneficiary will be disregarded. This alleviates some concern that such a remote contingent interest could disqualify the trust from favorable RMD treatment.

---

[1] This amount is now indexed for inflation.

[2] "Eligible designated beneficiaries" include the participant's surviving spouse or minor child, or a beneficiary who is disabled, chronically ill or less than ten years younger than the participant.

For additional details about the SECURE Act 2.0, please see the client memorandum on that subject accessible on the firm's website.

Strategies for an Environment of Increasing Interest Rates

Certain strategies capitalize on higher interest rates to reduce the actuarial value of a taxable gift or to gain other tax advantages.

- Transfers with Retained Interests. An effective strategy may involve a gift passing to the intended beneficiaries after the expiration of an interest which, because it is retained by the transferor, reduces the value of the gift. Certain retained interests are valued by reference to an IRS-determined rate of interest for the month of transfer. The greater the rate, the lower the gift tax value of the transfer. For example:
    - Qualified Personal Residence Trust ("QPRT"): A grantor transfers a primary or vacation residence to a trust (a QPRT) and retains the rent-free use of the residence for a term of years, after which it passes to his or her children. The gift tax value of the transfer is the fair market value of the residence, less the present value of the grantor's retained use (measured using the IRS-determined interest rate).
    - Grantor Retained-Income Trust ("GRIT"): For a grantor seeking to transfer wealth to an individual or individuals other than his or her closest family members[3], a trust which must pay its income to the grantor for a specified term of years can be considered. The gift tax value of the assets transferred is reduced by the value of the grantor's retained income interest (likewise measured using the IRS-determined rate).
- Charitable Remainder Annuity Trust ("CRAT"): A CRAT pays an annuity to an individual for a term of years or life, with the value of the remainder interest passing to charity generating a charitable deduction for tax purposes. The greater the IRS-determined interest rate, the greater the value of the remainder and charitable deduction.
    - For an interest retained by the grantor, the benefits include an income tax deduction.
    - For a transfer subject to estate tax, the benefits include an estate tax deduction.

By contrast, wealth transfer strategies taking advantage of low interest rates prevalent in the recent past are not as attractive at this time. Such strategies as intrafamily-loans, installment sales to intentionally defective grantor trusts ("IDGTs") and grantor retained annuity trusts ("GRATs") relied for success on asset appreciation at a rate greater than the IRS interest rate.

[3] The Tax Code renders the GRIT strategy ineffective for a transfer to a grantor's ancestor, lineal descendant, sibling or the spouse of the grantor or any such family member. However, it can be an effective strategy for transfers to nephews, nieces, etc., and non-family members.

New York Estate Tax Developments

New York's estate tax exemption has increased to $6,580,000 for deaths that occur in 2023.

The Benefit of Gifts. New York's estate tax remains a significant consideration, particularly because of the rapid phase-out of the exemption once the estate exceeds it in value (commonly known as the "estate tax cliff"). New York has no gift tax and its estate tax computation does not include lifetime taxable gifts, except those made within three years of death. Making gifts within the expanded federal exemption to reduce the taxable estate so that its value is within New York's exemption can eliminate New York's estate tax.

Connecticut Estate and Gift Tax Developments

The Connecticut estate and gift exemption is now equal to the federal exemption amount ($12,920,000) for 2023 and future years. It is subject to the same inflation adjustments and also to the same reduction (cut back to $5 million, plus the inflation adjustment, currently scheduled to occur in 2026) as the federal exemption amount.

Unlike New York State, Connecticut imposes a gift tax in conjunction with its estate tax, and Connecticut residents cannot reduce state estate tax liability through large lifetime gifts in the same way New York residents can. Furthermore, although the IRS has confirmed there will be no "claw back" under the federal estate tax for a decedent who has taken 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.

Conclusion

Changes in the law and economic environment present both challenges and opportunities in structuring wealth transfers and allocating income among individuals and entities in tax-advantaged ways. The Firm's professionals welcome your questions about this letter, other recent developments and estate planning strategies.

Sincerely,

DAVIDSON, DAWSON & CLARK LLP