CUMMINGS & LOCKWOOD LLC

DECEMBER 2018 CLIENT UPDATE

December 2018

Dear Clients and Friends:

We are writing to you as we do each year to advise you on changes in the federal and state tax laws and general estate planning developments we believe will be of interest to you. As we wrote in our December 2017/January 2018 Update, the Tax Cuts and Jobs Act of 2017 (the "2017 Tax Act") substantially increased the estate, gift and generation-skipping transfer ("GST") tax exemptions. Unfortunately, much like the tax legislation passed in 2001 and in 2010, the 2017 Tax Act does not provide us with complete certainty as the individual tax provisions of the Act apply for only eight years. Beginning January 1, 2026, the estate, gift and GST tax provisions of the Internal Revenue Code will revert to their pre-2018 versions unless further legislation is enacted to make the 2017 Tax Act changes permanent or otherwise alter the transfer tax system yet again.

Estate, Gift and GST Tax Rates and Exemptions for 2018 to 2026

The 2017 Tax Act increased the amounts exempt from the estate, gift and GST taxes to $10,000,000 (indexed for inflation from 2011). For 2018 this exemption amount is $11,180,000 and is scheduled to increase to $11,400,000 in 2019 when the inflation adjustment is taken into account. Amounts over the exemption levels which do not qualify for either the marital or charitable deduction are taxed at a flat 40% at the federal level. Because the gift and estate tax exemptions have been unified since 2011, this $11,400,000 exemption can be used during lifetime or at death or some combination of both.

For clients who used their entire gift tax exemption before 2018, the increased exemptions offer an opportunity to make additional gifts tax free that also can be sheltered from the GST tax. Even for those clients who had not yet used their lifetime gift exemptions, the increased exemption amounts make the coming seven years a good time to consider making lifetime transfers.

The End of the "Clawback" Concern

On November 20, 2018, the Internal Revenue Service issued proposed regulations to address one of the concerns of using the increased exemptions on gifts prior to 2026 - that is the potential for those gifts to be taken into account or "clawed back" into the estate tax calculations if the donor dies after 2025 when the exemptions have returned to their lower levels. The proposed regulations provide that gifts made between 2018 and 2025 which are sheltered from federal gift tax when made due to the use of the increased gift tax exemption will not be included or clawed back into the estate of the donor at his or her death in a manner that retroactively imposes tax on those gifts.

Do Not Assume The Increased Exemptions Automatically Help Your Estate Planning Without Further Consideration

Although in general the increased federal estate, gift and GST exemptions will help make estate plans more tax efficient, it is important to be certain that existing plans and future gifts are reviewed carefully in light of the new exemptions. This is especially true if your current Will or Trust divides your estate so that the share exempt from

estate tax passes to a beneficiary other than a trust for the benefit of your spouse or the share of your estate exempt from GST Tax does not pass to a trust that includes your children. In either case you should contact your Cummings & Lockwood attorney as soon as possible to consider whether the increase of the exemptions to more than $11,000,000 reduces the property passing to or in trust for your spouse or children to less than is desired.

Additional Considerations When Contemplating Gifts

Gifting Assets Means Losing a Step-Up in Basis

The potential estate tax savings from gifting should always be balanced against the fact that assets gifted during life do not receive a new "stepped-up" basis at death. For this reason, it is important to consider not only how much to give, but what assets to give, the current tax basis of those assets and the projected appreciation of such assets between the date of the gift and the date of death of the donor to be sure any estate tax savings are not outweighed by capital gains taxes upon the sale of the gifted assets.

Connecticut Has a Separate Gift Tax

When making gifting decisions, remember that if you live in Connecticut or plan to gift real estate located in Connecticut -- the only state that currently has a separate gift tax system -- it is important to take state taxes into account before acting. For example, as discussed in more detail below, Connecticut's 2018 gift tax exemption is limited to $2,600,000. The lower Connecticut exemption means that if a Connecticut resident makes a $11,180,000 gift in 2018, no federal gift tax will be due but a Connecticut gift tax of approximately $850,000 will be due on the $8,580,000 difference between the federal and Connecticut exemptions. The Connecticut gift tax exemption increases to $3,600,000 in 2019, and additional increases are scheduled to occur after 2019.

Annual Exclusion Gifts Should Be The First Consideration

Gifts that use a portion of the lifetime exemption are not as powerful as gifts that qualify for the annual exclusion from gift tax. Annual exclusion gifts do not reduce what can be transferred at death without incurring estate tax. Consequently, exemption gifts should be carefully considered if they will jeopardize the client's financial wherewithal to continue making the maximum annual exclusion gifts per beneficiary. For 2019, the annual exclusion from gift tax, i.e., the amount that an individual can give to any number of people each year without using gift exemption or incurring a gift tax, will remain at $15,000.

The 2017 Tax Act is Not Forever, and Might be Shorter-Lived Than Originally Intended

The 2017 Tax Act which implemented the new estate, gift and GST exemption amounts is only in effect through 2025. Beginning January 1, 2026, these exemptions will revert to their pre-2018 levels ($5,000,000 indexed for inflation) unless there is further legislative action to make the changes permanent. Although there was some discussion in Congress regarding passing such a change, the recent mid-term elections giving the Democrats a majority in the House of Representatives makes any such change unlikely before the 2020 elections. In fact, there is always the possibility of a new tax law which would actually result in a more rapid return to pre-2018 levels. For this reason, we encourage clients who are concerned that the exemption amounts may be reduced in 2026 or sooner to discuss their gifting strategies with their Cummings & Lockwood attorney now so that a strategic plan can be designed and implemented well in advance of any reductions in tax-free gifting capabilities.

Connecticut Again Makes Significant Changes to Estate and Gift Taxes

In 2018, the Connecticut estate and gift tax exemption has been increased from its prior level of $2,000,000 per donor to $2,600,000. It will increase to $3,600,000 on January 1, 2019. There is confusion as to what is to occur in 2020 and future years because in May of this year Governor Malloy and the Connecticut legislature enacted two different bills with respect to the Connecticut estate and gift tax.

Senate Bill 11 was passed by the Connecticut House of Representatives and signed by the Governor and would cap the Connecticut exemption amount at $5,490,000 as of January 1, 2020 and succeeding years rather than

matching the federal exemption of $10,000,000 indexed for inflation beginning on January 1, 2020. This bill was passed by the Connecticut House of Representatives on May 9, 2018. Thirty-nine minutes later, Senate Bill 543 passed the Connecticut House of Representatives and was later signed by the Governor. Under this Bill, the Connecticut exemption amount will be $5,100,000 in 2020, $7,100,000 in 2021, $9,100,000 in 2022 and will match the federal exemption amount effective January 1, 2023.

Due to the conflict in the two Senate Bills, the Legislative Commissioner's Office which resolves legislative conflict is expected to rule that Senate Bill 543 with the higher exemption amounts will be the governing law as it was passed by the House of Representatives later than Senate Bill 11. We will post an alert on our website once we have a definitive answer.

Regardless of which Bill is ultimately determined to be the binding law, the estate and gift tax cap, the maximum amount an individual is liable to pay to Connecticut in combined estate and gift tax, is still scheduled to decrease from $20,000,000 to $15,000,000 effective January 1, 2019.

Review and Current Status of Other State Estate Tax Laws

New York

On January 1, 2019 New York's estate tax exemption amount is scheduled to increase to match the federal exemption as it existed prior to 2014, meaning the New York exemption is set at $5,000,000 as indexed for inflation from that year forward. As a result, New York's estate tax exemption will not reflect the increased federal exemption passed in the 2017 Tax Act but rather will be approximately $5,700,000 for 2019.

New York's maximum estate tax rate remains at 16%. Most importantly, this estate tax is essentially a "cliff tax" meaning that the exemption is phased out for taxable estates that exceed the exemption amount and eliminated entirely for estates that are more than 105% of the exemption amount. Thus, any New York estate in excess of the exemption amount available for that estate by more than 5% will face a tax on the entire estate rather than just on the amount that exceeds the exemption. As New York does not have a gift tax, it may make sense for clients whose estates will exceed the cliff to begin reducing the size of their estate by making gifts during lifetime if doing so might eliminate the New York estate tax without incurring federal gift taxes. While New York's estate tax has a "look back" to bring gifts made within three years of death back into the estate for purposes of calculating the estate tax due, this look back does not apply to estates of decedents who die on or after January 1, 2019.

Twelve States and District of Columbia

There are twelve states that continue to have an estate tax: Connecticut, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont and Washington. In addition, the District of Columbia also has an estate tax. Clients who reside in or own property in these states may be subject to state estate taxes at death.

Florida and Thirty Seven Other States

Florida does not have an estate tax, and the state constitution prohibits the legislature from enacting a Florida estate tax on residents. Likewise, the thirty seven other states not listed above also have no estate or gift tax. Nevertheless, as noted above, anyone who owns property in the District of Columbia or one of the twelve states listed above may be subject to state estate taxes at death.

Federal Charitable Tax Law Changes of Note

Charitable deduction limitation increased to 60%

Each year, individuals may qualify for a charitable contribution deduction for amounts donated to qualified charities. The deduction that an individual may take on his or her personal income tax return is subject to an adjusted gross income limitation depending upon the type of asset contributed and the type of charity that received

the contribution.

Starting in 2018, the adjusted gross income limitation for cash gifts to public charities has been increased from 50% to 60% of an individual's adjusted gross income. The catch is that the increased limitation applies only to cash gifts. It is possible that Congress could make changes to this provision before year-end to make this narrow provision more widely accessible.

IRA Charitable Rollover made permanent

The IRA charitable rollover was made permanent in 2015. To take advantage of this provision, you must be an IRA owner over age 70½, and you must make a gift from your IRA directly to a qualified charity (which includes public charities but not split interest trusts, donor advised funds, private foundations, charitable gift annuities or supporting organizations). The maximum IRA charitable rollover gift is $100,000 per year, and can be counted toward satisfying your required minimum distributions for the year. An IRA charitable rollover does not generate **taxable income nor a tax deduction**, so you will benefit even if you do not itemize your tax deductions. And it allows you to support the work of a charitable organization that is near and dear to you!

Trust Registration Requirements for U.S. Trusts With Foreign Contacts

In 2015, the European Union enacted the European Union Fourth Anti-Money Laundering Directive requiring each of the member states to enact a Trust Register system by January 1, 2018. As a result, each of the member states has enacted a Trust Register. The EU gave each member state the freedom to determine the specifics of their respective Trust Register system. The United Kingdom has the most oppressive Trust Register system with France coming in a close second. As part of the UK's implementation of its Trust Register, it may be necessary for non-UK trusts to register with the UK tax authorities if the trust has even minimal connections to the UK (which can be investments in the UK, including investments in a UK public company, UK beneficiaries or UK source income among other things).

France's version of the Trust Register imposes annual reporting responsibilities on U.S. Trustees of trusts with one or more French beneficiaries. Each of the other member states have variations of Trust Registers. The penalties for failing to comply with the Trust Register can be significant. In addition to the Trust Register, the European Union has asked each of the member states to enact legislation on the public's ability to access information on the Trust Register.

In light of these new registration requirements, you may wish to review any trust connections to foreign countries to determine if you need to register any trusts you have created or of which you are a trustee. You also may want to instruct your investment advisors to refrain from investments in foreign assets that would trigger registration requirements. Of course, if you have questions about any trusts or their registration requirements, please contact your Cummings & Lockwood attorney.

Are You Due for An Estate Planning Checkup?

It is a good idea to periodically review your estate plan to be sure it still comports with your wishes and intentions. This is especially important if there has been a change in financial or family status such as marriage or divorce in the family or additional children or grandchildren have been born or if you or a family member has been diagnosed with a serious illness.

In addition, the recent federal tax law changes may affect how your estate planning documents operate. As discussed above, Connecticut is increasing its exemption from the Connecticut estate tax to "match" the exemption from the federal estate tax over a period of several years. We believe that "match" will eventually be a true match to the federal estate tax exemption, phased in over time and completed in 2023. But, as mentioned above, it is still possible the "match" will be to the 2017 federal exemption amount of $5,490,000.

In either event, the change to the federal tax law and the difference that will exist at least for the next few years between the federal exemption and the Connecticut exemption (or any other state with an estate tax that does not match the federal exemption), has significance for married clients with an estate plan that funds an estate tax sheltered trust with the maximum assets needed to completely utilize the federal estate tax exemption upon the death of the first spouse. If such plans are not adjusted, they could result in a state estate tax at the death of the first spouse which might be largely or entirely deferred and possibly avoided. For example, for a Connecticut couple a death of one spouse in 2018 would create a Connecticut estate tax of approximately $850,000 if the deceased spouse's estate plan fully funded an estate tax sheltered trust with the maximum property needed to fully utilize the federal estate tax exemption.

You may also want to review how your assets are owned and whether they have beneficiaries designated for them. It is extremely important that you review these items periodically to avoid accidentally undoing the dispositions in your Will and/or Revocable Trust. For example, if your Will creates equal trusts for your children, but you own stocks and bonds jointly with just one child or in a Transfer on Death or "TOD" account with that child named as the beneficiary, then that ownership designation supersedes your Will, and upon your death, that child will own all the stocks and bonds by operation of law. Your other children will receive nothing under the Will and any asset protection or tax benefits from the trust will be lost. Similar issues can arise with beneficiary designations for retirement plans and life insurance. Forms of ownership and distribution also can have a substantial impact on the amount of taxes due at your death, and may distort who is responsible for the taxes.

In Closing

Cummings & Lockwood continues to have one of the largest and most respected Trusts and Estates practices in the country. Our Private Clients Group has more than 80 attorneys, fiduciary accountants and paralegals devoted solely to the needs of individual clients and is complemented by Commercial and Litigation Groups to provide assistance to our individual clients and their family and closely-owned business interests. Our attorneys continue to be recognized in the ranks of Best Lawyers in America, Super Lawyers, the American College of Trust and Estate Counsel, and Chambers & Partners High Net Worth Guide. (For the recognitions of specific attorneys by these organizations and the criteria by which they are selected, please review the attorney biographies on our website at www.cl-law.com).

As always, we continue to monitor federal and state tax law developments and will endeavor to post alerts on our website (www.cl-law.com) with any major developments relating to estate, gift and GST taxes.

2018 PCG Annual Update Letter