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OCTOBER 2022 CLIENT UPDATE

We hope this letter finds you well and adjusting to all of the changes of the past few years. As we do every year, we are writing to advise you of various estate planning issues and to highlight some items which may be of interest, including the current status of federal and state estate, gift and generation-skipping transfer ("GST") tax provisions and some changes which have been made recently to Florida and Connecticut trust laws and federal retirement plan distribution rules.

As we unfortunately are becoming accustomed to saying each year, we still lack certainty regarding potential changes in the tax law. Although there is no large tax bill looming as we write this letter, many of the proposed tax law changes from prior years remain on the table for lawmakers to again possibly take up in due course. This letter will briefly identify some of the more frequently proposed federal tax law changes discussed in previous years which would have the greatest effect on estate planning. Please keep in mind, however, that many of these tax proposals have been raised, without becoming law, for many years now.

CURRENT AND FUTURE FEDERAL ESTATE, GIFT AND GST TAX RATES AND EXEMPTIONS

Year	Exemption	Tax Rate on Excess
2022-2025	$12,060,000*	40%
2026	$ 5,490,000**	40%

*as indexed for inflation and currently estimated to be $12,920,000 in 2023
**as indexed for inflation

CONSIDER ESTABLISHING AND FUNDING YOUR REVOCABLE TRUST NOW

A Revocable Trust (sometimes referred to as a "Living Trust" or a "Revocable Living Trust") is a popular and effective multi-purpose trust that will operate very differently at three distinct points in time:

1) While you are alive and capable of managing your affairs, you generally will be the sole beneficiary and the sole trustee or a co-trustee with your spouse of your Revocable Trust.

During this time, your Revocable Trust serves simply as your "alter ego," and you control and use the trust property much the same way you would without the trust.

2) If you become incapacitated, your named successor trustee steps in to manage the trust assets on your behalf. You remain the trust beneficiary and trust assets remain available for your use and care.

3) After your death, your Revocable Trust acts like a Will by disposing of the trust funds to or for the benefit of your named successor beneficiaries. This use of Revocable Trusts is becoming more important as we are seeing increasing probate and surrogate's court delays in processing and effectuating Wills.

When someone dies without first establishing and funding a Revocable Trust, assets in the decedent's name which pass under the Will are essentially frozen until the Will is accepted and the named executor officially appointed by the court. Delays of several weeks to several months may occur. On the other hand, assets held in the name of a Revocable Trust at death may be managed by the trustees within a day or so after death. This allows the trustees to immediately respond to market and other economic factors to preserve and safeguard assets. This is particularly important when market conditions are volatile and being able to quickly access and manage investments becomes crucial to preserving the value of the assets.

There are other benefits to using a Revocable Trust arrangement and funding it before death, including streamlining court oversight and expense, keeping the terms of the estate plan more confidential, potentially reducing the likely success of any challenge to the estate plan and avoiding state income tax in some instances. There essentially is no downside to using the Revocable Trust structure. If you already have a Revocable Trust but have not yet transferred your assets into the name of your trust, you should discuss this with your Cummings & Lockwood attorney at your next periodic estate planning review. Likewise, if you do not have a Revocable Trust but would like to explore creating one, please ask your Cummings & Lockwood attorney for our client memo on the subject and any additional information relevant to your particular situation.

RECENT CHANGES AND PROPOSED ADDITIONAL CHANGES AFFECTING RETIREMENT ASSETS

Recent changes to Retirement Plan rules: As a reminder, the Setting Every Community Up for Retirement Enhancement ("SECURE") Act, enacted at the end of 2019, significantly changed the rules for inherited retirement accounts, including increasing the required beginning date for a plan participant/account-owner to age 72. The most notable change under the SECURE Act was to require beneficiaries, other than a surviving spouse, to draw down the entire account balance no later than the last day of the 10th year following the participant/account-owner's death, rather than over the beneficiary's life expectancy. Although the Act, as written, did not include a required distribution schedule for the 10 year period as long as the entire account was withdrawn by the 10 year mark, recently proposed regulations from the IRS are interpreting the statute to require that if the original account participant died after the beginning date for his or her required distributions, then the beneficiary of the account must take annual distributions of a required minimum amount based on the beneficiary's life expectancy for the first 9 years and must withdraw the balance of the account in year 10. There are some exceptions for minor children of the participant (whose 10 year draw down window begins when they reach the age of majority), disabled or chronically ill beneficiaries, and beneficiaries not more than 10 years younger than the deceased owner.

FLORIDA RULE AGAINST PERPETUITY EXTENDED TO ALLOW 1,000 YEAR TRUSTS

As of July 1, 2022, trusts created in Florida can now exist for up to 1,000 years. This is an extension of the previous limit of 360 years. This extended time limit is effective for trusts created on or after July 1, 2022 or which become irrevocable after that date.

FLORIDA SPOUSAL TRUSTS THAT CAN REVERT BACK TO THE FUNDING SPOUSE

A recent change to Florida trust law has made certain irrevocable trusts which include the grantor's spouse as a beneficiary more attractive. Trusts which are created and funded by one spouse (the "grantor spouse") for the benefit of the other spouse (the "beneficiary spouse") are often called Spousal Estate Reduction Trusts ("SERTs") or Spousal Lifetime Access Trusts ("SLATs"). SERTs are a popular gifting vehicle because they allow gifts to reduce the grantor spouse's estate while still allowing the beneficiary spouse direct access to the gifted assets if needed. Generally, if the beneficiary spouse were to die before the grantor spouse, the trust assets are no longer available, even indirectly, for the grantor spouse. SERTs created in Florida on or after July 1, 2022 can potentially address this drawback. The new law allows the grantor spouse to become a beneficiary after the death of the beneficiary spouse. There are important considerations in how the trust is drafted and when and how the grantor spouse's secondary interest is created that need to be addressed when considering such a trust. If you would like more information to determine if such a trust might present a good gifting opportunity for you, please contact your Cummings & Lockwood attorney.

PROPOSED LEGISLATIVE CHANGES

The major tax proposals that were introduced in the last few years included reductions in federal estate and gift tax exemptions and increases in tax rates, as well as changes to the generation-skipping transfer ("GST") tax rules and limits on the length of time trusts can remain exempt from GST tax. Other proposals included the elimination of the "step-up" in basis and potential capital gains tax at death provisions, changes in the rules for valuing certain closely-held business interests, and changes in income tax rates. All of these were discussed in detail in our letter last year, as many of them were then being considered as part of the Build America Back Better Act ("BABB Act").

The BABB Act was subsequently passed without any of the estate, gift and trust tax changes which we had been monitoring. However, earlier this year the Biden Administration released its "General Explanation of the Administration's Fiscal Year 2023 Revenue Proposals" ("Revenue Proposals") which states the Administration's support for several changes to the estate and gift tax system. It is important to note that none of these proposals is currently included in legislation which is slated to be enacted, but we are summarizing some of the major points here so you are aware of what continues to be considered in Washington as potential changes to the estate, gift and GST tax laws:

<u>Capital Gains/Step-up In Basis</u>
The Revenue Proposals include repealing the "step-up in basis" rule. Under current law, assets subject to estate tax at death receive a basis adjustment for income tax purposes equal to the date of death value which essentially eliminates the pre-death capital gains. The step-up in basis rule coupled with higher federal estate tax exemptions mean that many estates do not pay estate tax or income tax on unrealized appreciation in asset values during the decedent's lifetime. Under the proposal, transfers by gift or by death would be realization events that trigger capital gains tax to be due. Any capital gains tax due at death would be deductible against the estate tax.

<u>Grantor Retained Annuity Trusts</u>
The Administration's proposal would require Grantor Retained Annuity Trusts (GRATs) to have (1) a minimum 10 year term; and (2) a remainder interest equal to at least the greater of $500,000 or twenty-five percent (25%) of the value of the assets transferred to the GRAT (capped at the value of assets transferred to the GRAT). In addition, the grantor would be prohibited from tax free "swaps" during the term of the GRAT. These proposals would eliminate the use of popular "zeroed out" GRATs which have been used to transfer substantial wealth without having to use more than a nominal amount of gift exemption.

<u>Grantor Trusts</u>
One popular planning technique is for an individual (the "grantor") to make gifts to an irrevocable "grantor trust" which, under current law, not only excludes the gifted assets from the grantor's taxable estate at death, but allows the grantor to further reduce his or her taxable estate by remaining obligated to pay income taxes on income earned on the assets in the grantor trust during the grantor's lifetime. The Administration proposes treating the income tax paid as an additional gift for gift tax purposes for trusts created after the date of enactment and would require that sales between a grantor and a grantor trust be taxable events.

<u>Limit the Duration of GST Exemption</u>
The Administration is proposing to limit the applicability of the GST exemption to two generations below the transferor or those alive at the creation of the trust.

Again, as of now these are simply proposals put forth by the Biden Administration. We will be watching to see if any of these proposals make their way into legislation.

WHO SHOULD CONSIDER GIFTING BEFORE THE END OF 2025 OR SOONER IF ONE FEARS TAX LAWS MAY CHANGE BEFORE THEN?

- Clients who are certain they will never need the gifted assets and can maintain financial independence without those assets and the income they may generate.
- Clients who believe the property they gift will appreciate in value before death.
- Clients who believe and are willing to proceed on their belief that federal tax exemptions soon will be reduced below the current level for a prolonged period of time.
- Clients who are willing to gift the entirety of their exemption now, or at least the majority of it. Because the exemptions may be decreased later, you must give enough now to use

what might be taken away. For example, if you have $12,060,000 in exemption and use $4,000,000 on gifts now, and the exemption is later reduced to $5,000,000, you will only have $1,000,000 of exemption left after the reduction. The $4,000,000 you use in gifts now will be applied against whatever exemption is left after the reduction. In other words, the gift will not be taken "off the top" of the higher exemption amount; it will simply be applied to whatever exemption exists later. That means making large gifts now is the only way to capture or "lock in" the difference between the historically large exemption amount, and whatever reduced exemption may be enacted.

OTHER CONSIDERATIONS RELATING TO GIFTING NOW

When making gifting decisions, remember to consider capital gains and state tax implications:

- Connecticut has a separate state gift tax with an exemption of $9,100,000 in 2022. This means that if a Connecticut resident who has not used gift tax exemption in the past makes a $12,060,000 gift to take full advantage of the federal gift exemption available in 2022, a Connecticut gift tax of $351,200 will be due on the $2,960,000 difference between the federal and Connecticut exemptions. (The Connecticut exemption will increase to match the federal exemption as of January 1, 2023.) This tax can be avoided if the gift involves real property or tangible personal property located out-of-state, as such property located outside of Connecticut is not subject to Connecticut gift tax. Conversely, gifts by non-residents of real property and tangible personal property located in Connecticut are subject to Connecticut's state gift tax.
- New York does not have a gift tax but does have an estate tax with an exemption of $6,110,000 in 2022. This means a New York resident who has not used any gift tax exemption in the past can gift up to $12,060,000 during 2022 and pay no federal or New York gift tax, while the same transfer at death would incur roughly $1,395,000 of New York estate tax. (Note, however, that gifts made within three years of death are brought back into a New York resident's estate for purposes of calculating New York estate taxes.)
- Florida has no separate state gift or estate tax.
- Under current law, gifting can result in a trade-off of capital gains tax savings for estate and gift tax savings since the gifted assets retain the donor's cost basis and would not qualify for a stepped-up basis at death.

IN CONCLUSION

We recognize changes to tax laws may come at any time. As we have customarily done, we plan to monitor tax and other trust and estate law proposals and post alerts on our website (www.cl-law.com) with any major developments, as well as a summary of the relevant provisions of any final tax law that is enacted. In the meantime, please feel free to contact your Cummings & Lockwood attorney with any questions.

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