CUMMINGS & LOCKWOOD LLC

# 2024 PRIVATE CLIENTS ANNUAL UPDATE

September 26, 2024

We hope that you and your family are enjoying a healthy and happy 2024. As another year passes, we once again find ourselves facing uncertainty concerning the future of the federal gift, estate and generation-skipping transfer ("GST") tax regime resulting from both the upcoming 2024 federal elections and the scheduled sunsetting of the Tax Cuts and Jobs Act of 2017 (the "2017 Tax Act") on December 31, 2025.

You may recall that, beginning January 1, 2026, the estate, gift and GST tax provisions of the Internal Revenue Code will revert to their pre-2018 versions unless there is further legislative action to make the 2017 Tax Act changes permanent or otherwise alter the transfer tax system yet again.

As of the writing of this letter, former President Trump has not released a fully detailed tax plan as part of his bid for reelection, but he has suggested that he intends to extend the expiring provisions of the 2017 Tax Act. Conversely, it is likely that a Democratic Administration would allow the 2017 Tax Act to expire. Should the Democrats win the White House and a majority in the Senate and the House of Representatives, in addition to allowing the 2017 Tax Act to expire, the Democrats could push for additional tax legislation raising the estate tax rates and curtailing some of the most effective gift and estate tax strategies, and it is possible that this legislation could be effective retroactively.

While there is no guarantee that the 2017 Tax Act will expire on December 31, 2025, clients who can afford to and are inclined to maximize the use of their exemptions (described below) in the near future may want to take advantage of current law in advance of the pending sunset at the end of 2025.

**FEDERAL ESTATE, GIFT AND GST TAX RATES AND EXEMPTIONS**

| Year | Exemption | Rate |
|---|---|---|
| 2024 | $13,610,000 | 40% |
| 2025 | $13,610,000* | 40% |
| 2026 | $ 6,800,000* | 40% |

* or greater based on inflation

**WHO SHOULD CONSIDER GIFTING DURING 2024 AND 2025**

- 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 are confident the gifted property will appreciate in value before death.
- Clients who believe that federal tax exemptions will be reduced below the current level for a prolonged period.
- 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 $13,610,000 in exemption now and use $4,000,000 on gifts, and the exemption is later reduced to $5,000,000, you will only have $1,000,000 of exemption left. 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 the difference between the historically large exemption amount, and whatever the exemption is subsequently reduced to.

### CAPITAL GAINS AND STATE TAX IMPLICATIONS OF GIFTING

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

- Connecticut is the only state with a gift tax. As of 2024, the Connecticut gift tax exemption mirrors the federal gift tax exemption. The Connecticut gift tax does not apply to gifts by Connecticut residents of out-of-state real property or tangible personal property, but it does apply to gifts by non-Connecticut residents of real property and tangible personal property located in Connecticut.
- New York has no gift tax but has an estate tax with an exemption of only $6,940,000. This means a New York resident who has not used any gift exemption in the past can gift up to $13,610,000 during 2024 and pay no federal or New York gift tax, while the same gift at death would incur a $1,644,400 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.
- Gifting can result in a trade-off of capital gains tax savings for estate and gift tax savings because gifted assets retain the donor's tax basis for capital gains tax purposes in the hands of the recipient while assets inherited at the donor's death receive a "step-up" in tax basis to date of death value.

## GIFTING TECHNIQUES TO CONSIDER BEFORE DECEMBER 31, 2025

### GIFTS TO ESTATE REDUCTION TRUSTS FOR SPOUSE AND/OR OTHER FAMILY MEMBERS

A Spousal Estate Reduction Trust, sometimes referred to as a Spousal Lifetime Access Trust ("SLAT), is an irrevocable trust created by one spouse (the "Grantor Spouse") for the benefit of the other spouse (the "Beneficiary Spouse") and/or other family members to remove assets and their appreciation from the Grantor Spouse's taxable estate. For married couples, a gift to such a trust can be particularly attractive because the Beneficiary Spouse can be the primary beneficiary of the trust, allowing the assets to remain available to the Beneficiary Spouse. In addition, if you choose to allocate GST exemption to the gifts to a SLAT, the trust assets and their appreciation can also be removed from the GST tax system for as long as the trust exists, meaning that eventual distributions from the trust to grandchildren and more remote descendants can be made without any transfer tax.

### FLORIDA BACK-END SLAT

One of the primary drawbacks of a traditional Spousal Estate Reduction Trust or SLAT is that in most states the Grantor Spouse cannot directly benefit from the SLAT. This traditional design requirement can present a problem for the Grantor Spouse if the Grantor Spouse survives the Beneficiary Spouse. Fortunately, the Florida Statutes were modified as of July 1, 2022 to permit the inclusion of the Grantor Spouse as a beneficiary of the SLAT after the death of the Beneficiary Spouse (referred to as a "Back-End SLAT").

While the Back-End SLAT is an interesting option for clients who wish to retain access to the trust property after the death of the Beneficiary Spouse, it is not without risks. The primary issue is whether the IRS would treat the Grantor Spouse as having retained an indirect interest in the trust, thereby causing federal estate tax inclusion. The IRS has issued several rulings addressing this issue that essentially boil down to whether there is a preexisting arrangement with the Grantor Spouse on how trust assets will be distributed after the death of the Beneficiary Spouse. Therefore, it is imperative that no such prearrangement exist between the Grantor Spouse and the Beneficiary Spouse and/or a third party that the Beneficiary Spouse or such third party will add the Grantor Spouse as a beneficiary or that a Trustee will make distributions to the Grantor Spouse should the Grantor Spouse become a beneficiary.

In addition to possible estate tax inclusion, because the Back-End SLAT lacks specific support under the Treasury Regulations, the IRS could decide to subject these trusts to the IRS's anti-abuse regulations which would have severe adverse tax consequences. Despite these issues, for some it may be worth the risk to permit the Grantor Spouse to be a future, potential beneficiary of the SLAT.

**GIFTS TO DYNASTY TRUSTS**

A Dynasty Trust is a trust that is designed to benefit multiple generations by continuing to hold property in trust for each generation with the assets in the trust exempt from estate tax and GST tax. The current increased gift and GST tax exemptions present an excellent opportunity to benefit grandchildren, great-grandchildren and more remote descendants by using those increased exemptions to fund a Dynasty Trust. Estate Reduction Trusts (discussed above) can be designed as Dynasty Trusts. Trusts in Florida can be designed to exist for as long as 1,000 years and, with Connecticut's recent trust law changes, trusts in Connecticut can be designed to exist for up to 800 years. Because of these extended time periods, Florida and Connecticut residents no longer have to establish Dynasty Trusts in states like Delaware in order to take advantage of longer trust terms. New York, however, still requires that trusts terminate within approximately 90 years so New York residents may want to consider establishing trusts in jurisdictions such as Connecticut, Florida or Delaware for this reason.

**QUALIFIED PERSONAL RESIDENCE TRUSTS ("QPRTs")**

A Qualified Personal Residence Trust is a tax-efficient means of transferring a personal residence to your intended beneficiaries. The concept of a QPRT is relatively simple: the owner of the personal residence transfers it to a trust but retains the right to live rent-free in the residence for a specified number of years. In order to be successful, the original owner must survive the specified number of years. If the original owner is alive at the end of that period, ownership of the residence is transferred to the beneficiaries (or a trust for their benefit) and the value of the residence is removed from the estate of the original owner. At that time, the original owner can rent the property from the beneficiaries (or trust) if he or she wishes to continue to use the residence.

The primary tax advantage of the QPRT comes from the way in which the value of the residence is calculated for gift tax purposes. The value of the gift is not the full value of the residence on the date of the gift, but rather the present value of the beneficiaries' right to receive the residence only after the specified number of years. Generally, no matter how a QPRT is structured to reduce the value of the gift, the gift will still be substantial. With the impending sunset of the 2017 Tax Act, QPRTs may be an appropriate vehicle for people who are looking to use their available exemption before it disappears but do not wish to give away other income-producing assets.

**GIFTS TO LIFETIME MARITAL OR "QTP" TRUSTS**

A Qualified Terminable Interest Property ("QTIP") Trust can be established by you during your lifetime for the benefit of your spouse. No gift tax is imposed on the transfer of assets to a QTIP Trust because the trust qualifies for the marital deduction. While Lifetime QTIP trusts do not use gift tax exemption and therefore are not an effective vehicle for locking in the temporarily increased gift exemption, these trusts allow you to take advantage of your increased GST exemption in a manner that allows your spouse to continue to have access to the assets during the spouse's life.

**FRACTIONAL INTEREST GIFTS**

Gifts of fractional interests in assets such as real estate, limited liability companies and closely owned corporations can be an effective way to leverage the use of your available gift and GST exemptions because the fair market value of a fractional interest in property is often less than its corresponding proportion of the fair market value of a 100% interest in the property. This is because there is no ready market for the sale of those fractional interests and those who own fractional interests have little or no control over the property. Therefore, an appraiser will take into account this lack of marketability and lack of control when valuing the fractional interest. Any of the trusts discussed above can be funded with fractional interests in property that take advantage of this valuation method in assessing fair market value.

## MORE REASONS TO CONSIDER ACTING NOW

Various legislative proposals which have been circulating for years could more likely be enacted if the Democrats control Congress and the White House, and it is possible that the new laws could be effective retroactively. Recently, the Democrats introduced the American Housing and Economic Mobility Act of 2024 in the House of Representatives and the Senate. Like other proposals introduced in the past, this legislation, if enacted, would eliminate certain gifting and estate planning techniques entirely or significantly curb their effectiveness. These include:

- Requiring Grantor Retained Annuity Trusts ("GRATs") funded after enactment to have a minimum term of 10 years and a remainder greater than zero, or possibly eliminating GRATs altogether.
- Eliminating or curtailing the tax benefits of QPRTs.
- Imposing a time limit on the protection from GST tax for multi-generational trusts to which GST exemption is allocated.
- Severely limiting the use of "grantor trusts" that permit donors to pay the income tax on the taxable income generated by assets gifted into trust without such tax payments being treated as additional taxable gifts.
- Eliminating the "step-up" in basis rules or imposing a capital gains tax on appreciated property at death.
- Eliminating discounts on fractional interest gifts

## OTHER ITEMS OF INTEREST

### CORPORATE TRANSPARENCY ACT

Recent regulations implementing the U.S. Corporate Transparency Act require most companies, including limited liability companies and corporations, to file a report with the U.S. Department of the Treasury identifying the company's ultimate beneficial owners. A beneficial owner is any natural person who, directly or indirectly, either (i) exercises substantial control over the reporting company, or (ii) owns or controls at least 25% of the ownership interests of the reporting company.

While there are some exemptions from reporting, these are generally limited to companies that are otherwise highly regulated, such as publicly traded companies, banks and operating companies with more than 20 full-time employees and more than $5 million in annual recorded gross receipts or sales in the prior year's tax return.

Many of our clients have LLCs or other entities which do not fall under an exemption. This includes, but is not limited to, entities formed: to hold real estate; to manage publicly-traded securities and/or private equity investments; to hold tangible assets (e.g., horses, boats, artwork); to run consulting businesses; to run family businesses; and to establish and run family offices. The statute applies to entities that have only one member or shareholder as well as those with multiple members or shareholders, and it applies even if all of the members or shareholders are family members or trusts.

*The obligation to report is on the companies and those persons in substantial control of them. There are both civil and criminal penalties for failure to comply, with civil penalties of up to $500 per day and criminal penalties of up to $10,000 in fines and two years in prison. These regulations require that any non-exempt company created on or after January 1, 2024 file a report within 90 days of creation and that companies created before 2024 file a report identifying their beneficial owners no later than December 1, 2024. This deadline is fast approaching,*

We are available to answer any questions regarding compliance with the Corporate Transparency Act regulations, including what information must be filed and whether protective changes to your organizational documents are warranted.

### CONNECTICUT DECANTING STATUTE

While Florida, New York and many other states have had trust "decanting" statutes for several years, Connecticut has not. Earlier this year, Connecticut passed a statute which specifically authorizes the decanting of irrevocable trusts in Connecticut. "Decanting" is the act of a Trustee distributing the assets from an existing irrevocable trust ("Old Trust") to a new irrevocable trust ("New Trust") which has different terms that are more suitable for current circumstances.

The new statute will be effective as of January 1, 2025 and will apply to all Connecticut trusts, whenever created, for which Connecticut law governs the administration of the trust. The extent to which a trust can be decanted is determined in part by the terms of the trust itself. Generally speaking, the more distribution discretion the Trustee of the Old Trust has, the more the terms of the New Trust can differ from those of the Old Trust. In all events, beneficiaries who already have vested interests in the Old Trust cannot be reduced or eliminated in the New Trust.

There are some notice requirements to decant a trust, but generally the Trustee can act unilaterally within the scope of the statute to complete the decanting. This means court approval and/or the permission of the trust creator and beneficiaries is not required, although there are additional compliance issues if the trust has charitable beneficiaries.

**WITHHOLDING ON RETIREMENT INCOME DISTRIBUTIONS**

Currently Connecticut income tax rules require withholding on certain retirement income distributions (e.g., pensions, annuities, deferred compensation plans, IRAs and stock bonuses). New Connecticut legislation effective for taxable years beginning on or after January 1, 2025, permits, rather than requires, income tax withholding on these distributions. The new law provides withholding is required only if the payee requests the withholding or if the payee does not request to have an amount withheld from the distribution and the distribution is of a "lump sum" (defined as a distribution of more than $5,000 or 50% of the payee's entire account balance, whichever is less). In such cases, withholding at the highest marginal tax rate will still be required.

**BUY-SELL AGREEMENTS FOR CLOSELY-HELD COMPANIES**

A recent United States Supreme Court case regarding the valuation of an interest in a family business for estate tax purposes may warrant taking a second look at succession plans for closely-held businesses.

It is common for owners of a closely-held business to enter into an arrangement to control the disposition of shares in the company if one owner dies. Often this takes the form of a "buy-sell agreement" in which all owners and/or the company itself are required to purchase the shares of a deceased owner and the deceased owner's estate is required to sell the shares. To fund the purchase of shares, the company will often purchase life insurance on the lives of the owners.

On June 6, 2024, the Supreme Court issued its ruling in *Connelly v. United States* and upheld the IRS's position that life insurance death benefit proceeds payable to a company to fund its obligation to redeem shares from a deceased owner in a "buy-sell agreement" increase the fair market value of the deceased owner's shares. In essence the value of the insurance proceeds received by the company which result from the death of a shareholder is added to the value of the company to determine the date of death value of the decedent's stock, thereby increasing the potential estate tax due.

In light of the Supreme Court's decision, we recommend that owners of closely-held businesses consult with their attorneys and tax advisors to review and potentially update their buy-sell arrangements to ensure they are structured with estate tax implications in mind.

**FLORIDA COMMUNITY PROPERTY TRUSTS**

In community property states, when one spouse dies, the marital assets receive a full step-up in tax basis to date of death value. In non-community property jurisdictions, such as Florida, Connecticut and New York, there is a step-up in tax basis only on the deceased spouse's assets.

As of July 1, 2021, Florida became the fifth non-community property state to permit the creation of Community Property Trusts ("CPTs"). These CPTs allow married couples to benefit from some of the laws applicable in community property jurisdictions, most notably a full step-up in basis on all assets in the trust at the death of the first spouse to die. There are specific provisions which are required in order for these trusts to be valid, including the requirement of a "Qualified Trustee" who is a resident of Florida or a bank or trust company authorized to act as a Trustee in Florida. Both Florida residents and non-Florida residents may set up these trusts under Florida law.

These CPTs could benefit clients who have (i) highly appreciated property and concentrated positions of stock which could be diversified at death following a full step-up in basis with minimal capital gains tax consequences or (ii) rental or investment real estate that the surviving spouse does not want to continue to manage after the death of the first spouse and who are willing to allow the surviving spouse to control the disposition of half of those assets.

**THE FINAL MONTHS OF 2024**

As we all await the results of the federal elections in November, you should consider what family gifting strategies you might be inclined to undertake now if it appears the tax laws will change in the near future.

Accordingly, we suggest that any clients who are certain that they want to make gifts to use their exemption in 2024 or early 2025 should contact their Cummings & Lockwood attorney as soon as possible to discuss getting started. Likewise, anyone who plans to make a large gift to a new trust at any time in 2025 should discuss with their attorney putting the framework in place in advance.

To view as a PDF:


2024 PCG Annual Update Letter without Rates