STROOCK
SPECIAL BULLETIN

New Tax Law Provides Dramatic Estate, Gift and GST Tax Relief

Temporarily Doubles Exemptions from $5,490,000 to Approximately $11,180,000 per Person (Approximately $22,360,000 per Married Couple)

Opens Wide Window for Gifting Opportunities

January 4, 2018

On December 20, 2017, Congress passed far-reaching changes to the Internal Revenue Code (the "2017 Tax Reform Act")[1] that provide significant estate planning opportunities to take advantage of a doubling of the estate, gift and generation-skipping transfer ("GST") tax exemptions. This doubling of the federal estate, gift and GST tax exemptions from $5,490,000 in 2017 to approximately $11,180,000 per person (and to approximately $22,360,000 for a married couple)[2] as of January 1, 2018 creates both (1) a window of opportunity for gifting due to the significant expansion of federal gift and GST tax exemptions and (2) a need to review existing wills and other estate planning documents to ensure that they continue to carry out planning objectives.

There is a "catch" to this legislation, as it "sunsets" its doubling of the federal estate, gift and GST tax exemptions on January 1, 2026, reverting to their pre-2018 exemption levels, as indexed for inflation.

In this **Stroock Special Bulletin**, we summarize the key provisions of the 2017 Tax Reform Act that pertain to estate, gift and GST taxes and the significant gifting opportunities that are now presented.

A comparison of the federal estate, gift and GST tax provisions under the prior law and the 2017 Tax Reform Act is set forth below:

1 Public Law 115-97 (the "2017 Tax Reform Act") is also informally known as the "Tax Cuts and Jobs Act."

2 The amounts are approximate subject to the computation and announcement of the actual inflation-adjusted amounts by the Internal Revenue Service.

	Prior Law as of December 31, 2017	New Law from January 1, 2018 through December 31, 2025	New Law as of January 1, 2026
Estate, Gift and GST Tax Exemption Amounts	$5,490,000 per individual / $10,980,000 per married couple	Approximately $11,180,000 per individual / $22,360,000 per married couple[3]	$5,490,000 per individual / $10,980,000 per married couple, as indexed for inflation
Estate, Gift and GST Taxes Imposed	Yes	Yes	Yes
Step-Up In Basis for Inherited Property at Death to Fair Market Value	Yes	Yes	Yes
Estate, Gift and GST Tax Rates	40%	40%	40%

Expanded Gifting Opportunities to Transfer up to Approximately $11,180,000 per Individual (Approximately $22,360,000 per Married Couple) Gift-Tax Free

Gift Tax Annual Exclusion Expected to Increase to $15,000 per Donee

Although the doubling of the exemptions will not expire until the end of 2025, affluent individuals will wish to consider securing use of the increased exemptions in 2018.

Under the new tax law, individuals are now able to transfer approximately $11,180,000 free of estate, gift and GST tax during their lives or at death. A married couple will be able to transfer approximately $22,360,000 during their lives or at death. And due to the portability provisions described above, any unused Federal estate tax (but not GST tax) exemption for the first spouse to die may be used by the surviving spouse for lifetime gifting or at death.

Individuals who previously exhausted their $5,490,000 gift tax exemption now have the opportunity to gift another approximately $5,690,000 (or approximately $11,380,000 in the case of a married couple who has previously exhausted their gift tax exemptions), and can even make such gifts to grandchildren or more remote descendants (or to trusts for their benefit) without incurring a GST tax.

The annual exclusion gifting amount was $14,000 (or $28,000 if spouses elect to split gifts) for gifts made in 2017. This amount is subject to indexing in future years, and is expected to increase to $15,000 (or $30,000 if spouses elect to split gifts) for gifts made in 2018. [4]

The increase of the exemptions gives individuals vast opportunities to leverage their gifting for multiple generations through the following techniques: [5]

- Topping off prior planning by making gifts to existing and/or new family trusts including generation-skipping trusts, insurance trusts, spousal lifetime access trusts and grantor retained annuity trusts ("GRATs")

[3] The amounts are approximate subject to the computation and announcement of the actual inflation-adjusted amounts by the Internal Revenue Service.

[4] These amounts are estimated and subject to the computation and announcement of the actual inflation-adjusted amounts by the Internal Revenue Service.

[5] There is some concern that the sunset provisions of the new law could potentially pose a "clawback risk" if an individual were to gift away his or her entire gift tax exemption during that person's lifetime and then die after December 31, 2025 at a time at which the unified estate and gift tax exemption was less than the amount that the individual had gifted away during that person's lifetime. Congress has recognized the need to address this potential issue by authorizing the U.S. Department of Treasury to issue guidance.

- Making new sales to intentionally defective grantor trusts ("IDGTs") or, where appropriate, making cash gifts to facilitate the prepayment of existing installment obligations to senior family members
- Making new intra-family loans (or, where appropriate, cash gifts to facilitate the prepayment of existing loans from senior family members)

Special Considerations for New York Residents

Expanded Federal Exemptions Give New Yorkers Greater Opportunities to Plan Ahead to Reduce New York Taxable Estates and to Avoid the New York Estate Tax Cliff

As we reported in several previous *Stroock Special Bulletins*, New York State enacted legislation in 2014 reforming its estate, gift, and GST tax laws. One of the major changes of the 2014 New York tax law was the gradual increase of the New York State estate tax exclusion from $1,000,000 to the Federal level, anchored, however, to the exemptions provided under then-existing federal tax law. As of April 1, 2017, the New York estate tax exclusion amount increased from $4,187,500 to $5,250,000. The New York estate tax exclusion amount is scheduled to increase further on January 1, 2019 to $5,000,000, as indexed for inflation with 2010 as the base year for this purpose (this amount will very likely exceed $5,600,000).

One of the reasons why planning to maximize the use of both spouses' New York exclusion amounts is a bit tricky is that New York does not recognize portability of a deceased spouse's unused exclusion amount to the surviving spouse as the federal law does. As a result, many New Yorkers will continue to incorporate credit shelter trusts or disclaimer trusts in their wills to maximize the benefits of both New York and federal law exclusion amounts.

A dramatic consequence to New Yorkers of the doubling of the federal estate tax exemption under the 2017 Tax Reform Act is that there is now an approximately $5,930,000 spread between the federal and New York State estate tax exemptions. Furthermore, the benefits of an increase in the New York exclusion amount are effectively denied to wealthier New Yorkers. There is a cliff built into the tax calculation, which quickly phases out the benefits of the exclusion if the decedent's New York taxable estate (plus certain taxable gifts made within three years of death) is between 100% and 105% of the exclusion amount available on the date of death. The cliff completely wipes out the benefits of the exclusion if the decedent's New York taxable estate (and any such gifts added back) exceeds 105% of the exclusion amount available on the date of death. As a consequence, the increase in the New York estate tax exclusion amount only benefits individuals whose New York taxable estates (including taxable gifts made within three years of death) fall below the New York exclusion amount in effect on the date of death. In addition, the New York estate tax exemption is *not* portable to spouses for lifetime gifting or for use on the survivor's New York estate tax return, in sharp contrast to the federal estate tax exemption.

A comparison of the "spread" between the federal and New York State estate tax exemptions under both prior law and the 2017 Tax Reform Act is set forth below.

Prior Law

Date of Death	Federal Exclusion	New York Exclusion	Spread
April 1, 2017 to December 31, 2017	$5,490,000	$5,250,000	$240,000
January 1, 2018 to December 31, 2018	$5,600,000	$5,250,000	$350,000
January 1, 2019 and beyond	Same	Same	$0

2017 Tax Reform Act

Date of Death	Federal Exclusion	New York Exclusion	Spread
January 1, 2018 to December 31, 2018	Approx. $11,180,000	$5,250,000	Approx. $5,930,000
January 1, 2019 to December 31, 2025	Approx. $11,180,000*	$5,600,000*	Approx. $5,580,000*
January 1, 2026 and beyond	$5,600,000*	$5,600,000*	$0

*based on 2018 inflation-adjusted amounts, but could be higher

As a result of the dramatic spread between the federal and New York estate tax exemptions, decedents whose estates are below the Federal estate tax exemption amount may still owe significant New York estate tax if their estates exceed the New York estate tax exemption amount. For example, if an unmarried New York resident dies in 2018 with an estate of $10,000,000 (assuming no lifetime gifts were made), he or she will owe no Federal estate tax, but will owe $1,067,600 in New York estate tax (based upon current rates).

New Yorkers whose estates are within the 100% – 105% "cliff" range, or even whose estates only slightly exceed the New York estate tax exemption amount, may consider gifting such amount as would bring his or her taxable estate below the New York estate tax exemption amount. As an example, an unmarried New Yorker who has assets with a current value of $6,000,000 and is in relatively good health, may wish to consider gifting $400,000 at this time to his or her children or other intended beneficiaries. If such person dies more than three years after making the gift (or until the three-year look back expires),[6] when the New York exclusion amount will be $5,600,000 or greater (we will assume, for the sake of this example, no further indexing for inflation from the previously announced 2018 inflation adjustment amount), with a taxable estate of $5,600,000, his or her estate will owe no New York or Federal estate tax. In contrast, if the gift is not made and the person dies on January 1, 2021 with a taxable estate of $6,000,000, the estate will owe $510,800 in New York estate tax (based upon current rates). To summarize, by making a gift of $400,000 today, an individual can save his or her beneficiaries over $500,000 in New York estate tax if he or she survives three years after making the gift. This recommendation will not be affected by any subsequent changes to the Federal estate, gift and GST tax laws.

A further benefit to New York residents making lifetime gifts within the parameters of the expanded federal exemption is the ability to move assets out of the New York taxable estate without incurring any state-level gift tax. Because New York has no gift tax, and only adds back to the gross estate of New York resident decedents certain gifts made within three years of death, New Yorkers have the ability to insulate gifted property from New York estate tax (provided that the donor survives for three years) and may have the added benefit of reducing their New York taxable estate below the applicable exclusion amount on the date of their death. This can avoid the confiscatory impact of the "New York Estate Tax Cliff." For example, a gift of $11,180,000 by a New York

[6] New York's addback provision for certain gifts made within three years of death is currently scheduled to expire for persons who die on or after January 1, 2019.

resident who survives the gift by three (3) years can potentially save $1,788,800 of New York State estate tax (and possibly even more than that if the New York Estate Tax Cliff would otherwise apply). The New York estate tax savings could potentially be doubled (to $3,577,600) if both spouses were to fully use their federal exemptions by making lifetime gifts and each spouse survives the gift by three years.

The potential tax savings of such a gifting program should also be considered in tandem with the temporary expansion of the federal estate, gift and GST tax exemptions before the expanded federal exemptions revert to pre-2018 exemption levels on January 1, 2026. If one were also to factor in the sunset of the doubling of the federal estate, gift and GST tax exemptions on January 1, 2026 back to pre-2018 exemption levels, the combined federal and New York State estate tax savings from such gifts at this time would be increased by another approximately $1,800,000 ($3,600,000 for a married couple) to more than $3,500,000 for an individual and to more than $7,000,000 for a married couple as compared to persons who do not embark on a gifting program and allow their expanded federal exemptions to revert to pre-2018 exemption levels on January 1, 2026.

Popular Wealth-Transfer Techniques to Leverage Expanded Federal Gift and GST Tax Exemptions Remain Viable

In light of the significant increase to the Federal estate, gift and GST tax exemptions under the 2017 Tax Reform Act, individuals who wish to reduce or eliminate future estate taxes may consider maximizing their use of the increased gift tax exemption before the exemptions revert to pre-2018 levels on January 1, 2026. Strategies that remain viable and attractive include dynasty (generation-skipping) trusts, spousal lifetime access trusts ("SLATs"), GRATs, intra-family loans[7] and sales to intentionally defective grantor trusts. Brief explanations of these estate planning techniques are set forth below.

Dynasty (Generation-Skipping) Trusts

Through coordinated use of their federal gift and GST tax exemptions, individuals can create trusts with an aggregate value of up to approximately $11,180,000 (approximately $22,360,000 per married couple), which may benefit several generations of descendants while insulating the assets from gift, estate and GST taxes. These are sometimes referred to as "***dynasty trusts***."

Spousal Lifetime Access Trusts ("SLATs")

In addition, dynasty trusts may be structured to give the grantor's spouse access to the trust as a discretionary beneficiary of trust income and principal. Such trusts can provide comfort that transferred wealth would still be available for a married couple if needed down the road, and can essentially serve as a "rainy day fund" while allowing one to take maximum advantage of the new tax laws. Such trusts with spousal access rights are sometimes referred to as "***spousal lifetime access trusts***," or "***SLATs***."

Grantor Retained Annuity Trusts

Grantor Retained Annuity Trusts ("GRATs") are a popular technique used to transfer assets to family members without the imposition of any gift tax and with the added benefit of removing the assets transferred into the GRAT from the transferor's estate (assuming the grantor survives the initial term).

In a GRAT, you transfer assets to a trust, while retaining the right to receive a fixed annuity for a specified term. The retained annuity is paid with any cash on hand, or if there is no cash, with in-kind distributions of assets held in the trust. At the

[7] The interest rates that the IRS uses to value many transfers for estate and gift tax purposes continue to be near historic lows for now, but this trend is not expected to continue indefinitely, as most experts predict that interest rates will rise at some point in the future.

end of the term, the remaining trust assets pass to the ultimate beneficiaries of the GRAT (for example, your children and their issue or a trust for their benefit), free of any estate or gift tax.

The GRAT can be funded with any type of property, such as an interest in a closely held business or venture, hedge fund, private equity fund, or even marketable securities. The most important consideration is whether the selected assets are likely to appreciate during the GRAT term at a rate that exceeds the IRS hurdle rate (an interest rate published by the IRS every month). The hurdle rate is 2.6% for transfers made in January 2018. Other factors to take into account in selecting the assets to be gifted are whether the assets currently have a low valuation or represent a minority interest (which may qualify the assets for valuation discounts for lack of control and lack of marketability under current law).

Generally, the GRAT is structured so as to produce little or no taxable gift. This is known as a "zeroed out" GRAT. Under this plan, the annuity is set so that its present value is roughly equal to the fair market value of the property transferred to the GRAT, after taking into account any valuation discounts. There is virtually no gift tax cost associated with creating a zeroed out GRAT.

The value of the grantor's retained annuity is calculated based on the IRS hurdle rate – the lower the IRS hurdle rate, the lower the annuity that is required to zero out the GRAT.

Why is the interest rate important? Because if the trust's assets appreciate at a rate greater than the interest rate, the excess appreciation will pass to the ultimate beneficiaries of the GRAT free of any transfer tax. Thus, any asset that you think will grow more than 2.6% a year may be a good candidate for funding a GRAT.

Other benefits of a GRAT bear mentioning. The transfer to a GRAT is virtually risk-free from a valuation perspective. If an asset for which there is no readily ascertainable market value is transferred to a GRAT, and the IRS later challenges the value that you report for gift tax purposes, the GRAT annuity automatically increases in order to produce a near zero gift. Accordingly, there is essentially no gift tax exposure. It is should be noted, however, that GRATs generally do not provide the same opportunity for leverage for GST tax purposes that other estate planning techniques can provide in connection with transfers to or for the benefit of grandchildren or more remote descendants.

GRATs also enjoy an income tax advantage. A GRAT is a "grantor trust," meaning that you must pick up all items of income, credit and deduction attributable to the trust property on your personal income tax return. Being saddled with the income tax liability may seem like a burden, but it is actually a great estate planning advantage, in that it allows the trust property to grow income tax free for the beneficiaries, while reducing your estate.

There may be no better time than the present to consider GRATs while the IRS hurdle rate remains low and valuation discounts are available.

Intra-Family Loans

Another technique that works very well in a low interest rate environment is an intra-family loan. Each month the IRS publishes interest rate tables that establish the lowest rate that, if properly documented, can be safely used for loans between family members without producing a taxable gift.

Currently, these interest rates are near historic lows. For January 2018, the short-term rate for loans of up to three years is 1.68%; the mid-term rate for loans of more than three years and up to nine years is 2.18%; and the long-term rate for loans exceeding nine years is 2.59%. Funds that are lent to children, or a trust for the benefit of children, will grow in the senior family member's estate at this extraordinarily low interest rate, essentially creating a partial estate freeze plan. Those funds, in turn, can be put to use by the junior family member to purchase a residence or may be invested in a manner that hopefully will beat the hurdle interest rate.

Making a loan to a trust for your children may be even more advantageous than making a loan outright if the trust is intentionally structured as a grantor trust for income tax purposes. Ordinarily, the interest payments on the note must be included in your taxable income, but if the payments are made by a grantor trust, they will have no income tax ramifications to you.

Alternatively, depending upon one's circumstances, it may be more advantageous for senior family members to put some of their expanded federal gift and GST tax exemptions to work by making cash gifts to facilitate the prepayment of existing loans to family members and to trusts established for the benefit of family members.

Sales to Intentionally Defective Grantor Trusts

A sale to an intentionally defective grantor trust ("IDGT") can be an extremely effective planning strategy that takes advantage of the current market conditions, and in the case of a sale of a minority interest in an entity or a fractional interest in real property, valuation discounts. You would create an IDGT for the benefit of your children, grandchildren and more remote descendants. If there is an existing IDGT, all the better.

An IDGT provides two independent planning opportunities. First, you will pay the income tax on the income generated by the trust, including capital gains tax, thereby allowing the trust to grow for your children and their issue unencumbered by the income tax, while reducing your estate. In addition, you may engage in transactions with an IDGT without any income tax consequences.

For example, you can sell low basis property to an IDGT without recognizing a gain. An ideal way to lock into valuation discounts would be to sell a minority interest in a closely-held business or venture to an IDGT. That minority interest can be sold at a price taking into account discounts for lack of control and lack of marketability.

Under this plan, you would sell property to the trust and take back a note with fixed payments of interest and principal. Any property can be sold to an IDGT, but ideally the property would have a low current valuation, good prospects for appreciation and features that enable it to qualify for valuation discounts. If the principal on the note equals the fair market value of the property sold, no taxable gift results. In addition, if the assets appreciate in value above the interest rate on the promissory note, the excess growth in value may be used to retire the principal of the debt, leaving valuable property for your children.

Individuals who have previously exhausted their pre-2018 exemptions through prior gifting may want to leverage their gifting and the valuation discounts even further through new sales to grantor trusts or, where appropriate, by making cash gifts to facilitate the prepayment of existing installment obligations to senior family members from prior sales, before the expanded federal exemptions revert to their pre-2018 levels on January 1, 2026.

As mentioned above, the interest rates that can be used for this purpose are currently extraordinarily low. Unlike with GRATs, however, such plans may have valuation risks that need to be considered, particularly if the property sold is an interest in a closely-held business or venture.

Although sales to intentionally defective grantor trusts have been used widely for decades, in some recent audits, the IRS has attacked the technique on two fronts: first, by taking the position that the note given to the grantor by the trust in exchange for the purchased property should be ignored, resulting in a gift of the full value of the property transferred; and second, by attempting to treat the note as "equity" in the trust rather than "debt," resulting in the inclusion of the asset transferred to the trust in the grantor's gross estate for estate tax purposes. Although most practitioners believe that the IRS's positions conflict with the Internal Revenue Code, Treasury Regulations and prior case law, these audit challenges may be an indication that the IRS intends to attack such sales more vigorously.

The IRS recently brought a high profile challenge to a sale to a grantor trust in two companion Tax Court cases. In these cases, which involved a husband and a wife, the grantor sold assets to the trust in exchange for a promissory note that contained a "defined value formula." The formula provided that if the value of the assets were later determined by the IRS or a court to be different than the appraised value, the number of shares purchased would be adjusted to avoid the imposition of a partial gift tax. Both cases settled in March 2016, without the Tax Court having ruled on the efficacy of the defined value formula. There is a prior court case that supports the validity of this technique, but the IRS has made clear that it will continue to challenge defined value transactions. If you are considering a sale or exchange with an IDGT, you should consult your tax advisor regarding the potential risks and benefits of the various ways in which the transaction can be structured.

Taking Advantage of Extraordinary Planning Opportunities Now

Under the 2017 Tax Reform Act, the Federal gift, estate and GST tax exemptions increased to approximately $11,180,000 on January 1, 2018 (approximately $22,360,000 for a married couple), allowing individuals extraordinary multi-generational estate planning opportunities to use these exemptions through lifetime gifting before the exemptions revert to their pre-2018 levels on January 1, 2026. Selecting the optimal wealth transfer technique and the right assets to gift are of paramount importance.

Stroock's Personal Client Services Practice Group continues to monitor all developments out of Washington and will provide updates and guidance, including with respect to the U.S. Department of Treasury's and the Internal Revenue Service's issuance of guidance to address open points in the new legislation.

For More Information

Anita S. Rosenbloom
212.806.6026
arosenbloom@stroock.com

Kevin Matz
212.806.6076
kmatz@stroock.com

Etta Brandman
212.806.6027
ebrandman@stroock.com

Mayer Greenberg
212.806.6286
mgreenberg@stroock.com

Sharon B. Soloff
212.806.6103
ssoloff@stroock.com

For all our *Stroock Special Bulletins* on the Tax Reform Act, please visit our website Tax Reform Act: What You Need to Know (available at https://www.stroock.com/practices/tax-reform-act-need-to-know). And check back often — we'll be updating frequently with analysis of important developments.

New York
180 Maiden Lane
New York, NY 10038-4982
Tel: 212.806.5400
Fax: 212.806.6006

Los Angeles
2029 Century Park East
Los Angeles, CA 90067-3086
Tel: 310.556.5800
Fax: 310.556.5959

Miami
Southeast Financial Center
200 South Biscayne Boulevard, Suite 3100
Miami, FL 33131-5323
Tel: 305.358.9900
Fax: 305.789.9302

Washington, DC
1875 K Street NW, Suite 800
Washington, DC 20006-1253
Tel: 202.739.2800
Fax: 202.739.2895

www.stroock.com