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TRUSTS & ESTATES UPDATE

DECEMBER 2016

As one year closes and another begins, it is useful to evaluate your current state of affairs in light of your future goals and aspirations. Estate planning is an integral part of financial planning that prepares you and your family for an uncertain future in the context of your wishes for your legacy.

This *Trusts & Estates Update* provides an overview of some recent changes to consider as you face important decisions about your estate. Whether you are new to estate planning or have previously established an estate planning structure, Holm & O'Hara LLP will help you navigate these and future updates.

THE PRESIDENT-ELECT'S TAX PLAN

REPEAL OF THE FEDERAL ESTATE AND GIFT TAX

One component of Donald Trump's tax proposal is a repeal of the federal estate tax. The proposed repeal would allow individuals with large estates to transfer more of their wealth tax-free at death. However, since estate tax regimes vary across the states, the actual impact of the proposed federal estate tax repeal is uncertain.

For example, Connecticut, which has independent estate taxes, would be largely unaffected by a repeal of the federal estate tax. New York, on the other hand, updated its tax regime in 2014 to align with federal tax law. As a result, changes to the federal estate tax could have significant implications in New York. Regardless of current law, states will likely reevaluate their regimes should the federal estate tax be repealed.

Explore the potential consequences of an estate tax repeal based on your state of residence.

ELIMINATION OF BASIS STEP-UP AT DEATH

Under current law, tax on unrealized gain is forgiven at death. For example, if during her lifetime, an individual sold a house for \$1,000,000 that she originally purchased for \$400,000, she would owe tax on the \$600,000 gain. But if the individual left the house to her son on her death, he would take a basis step-up to the fair market value of \$1,000,000. If her son sold the property immediately, he would realize no gain—the tax on his mother's \$600,000 unrealized gain would be forgiven.

The Trump Tax Plan calls for elimination of this significant tax advantage, but it does not specify how the change will be put into effect. One possibility is that beneficiaries will take a carryover basis, inheriting the testator's basis with the property. In that case, individuals should ensure beneficiaries are not burdened with capital gain taxes in excess of the value of their inheritance. Another option would be to tax unrealized appreciation at death. In that case, individuals might avoid paying tax on gains by making lifetime transfers up to the exemption amount.

Build flexibility into your estate plan to prepare for potential changes under the Trump administration.

FEDERAL UPDATE

INCREASE IN EXEMPTION AMOUNT

The federal estate and gift tax exemption amount for 2017 has been adjusted for inflation to \$5,490,000 per individual, up \$40,000 from 2016. While this may not appear to be a substantial increase, it could represent a significant amount after growth or appreciation, especially for investment or development assets.

For families who have created estate planning structures in the past, the 2017 exemption amount is almost certainly higher than when the initial plan was put into place. For instance, prior to 2012, many families created estate planning structures – such as irrevocable trusts – out of concern for potentially adverse estate and gift tax changes. Those trusts typically were created based upon the 2012 exemption amount of \$5,120,000. Since the 2017 exemption amount is \$370,000 more, it may be beneficial to review your overall estate plan and consider whether you can increase estate tax savings by making further gifts to a trust.

Consult your estate planning attorney for an update if your estate plan dates to 2012 or earlier.

DISCOUNT VALUATION REGULATIONS

A common estate planning technique is to gift, sell or transfer interests in a limited liability company or family limited partnership to family members. The interests transferred often receive a valuation discount for tax purposes based upon lack of marketability or lack of control. This has been a valuable planning technique to help reduce the size of your estate by passing discounted assets to your family.

Recently, much attention has been given to regulations proposed in response to perceived abuses in overly aggressive valuation discounts. The proposed regulations under Section 2704 of the Internal Revenue Code would restrict the use of valuation discounts on interests transferred to family members, minimizing the effectiveness of such planning techniques.

While these regulations may be finalized in 2017, it is unlikely that they will be finalized or implemented soon, if at all. Given widespread objections to the regulations, the shifting political landscape, and a potential estate and gift tax repeal under the Trump administration, clients who have yet to begin this type of planning may wish to remain flexible by taking a “wait and see” approach.

Ensure that you are transferring interests in your LLC or family limited partnership for strategic reasons, such as asset protection or family planning, rather than simply in anticipation of an unfavorable regulatory climate.

ESTATE TAX CONSEQUENCES TO NON-U.S. CITIZENS

Estate tax issues often arise for couples in which one spouse is not a U.S. citizen. U.S. tax laws usually allow married individuals to pass an unlimited amount of assets to a spouse, free of gift and estate taxes. However, different laws apply to couples in which one spouse is not a U.S. citizen. When the surviving spouse is a U.S. citizen, he or she may benefit from the unlimited marital deduction. However, if the U.S. citizen dies first and transfers assets to a non-U.S. citizen spouse, estate taxes are imposed on assets surpassing the lifetime exclusion amount of \$5,490,000 for 2017.

To minimize estate tax liabilities, mixed-nationality couples may consider establishing a qualified domestic trust (QDOT) or an irrevocable life insurance trust, maximizing lifetime gifts or pursuing U.S. citizenship for both spouses.

Non-U.S. citizens may be classified as either nonresident aliens (NRAs) or non-U.S. citizen residents (“green card” residents). For tax purposes, it is usually better to be classified as an NRA, since the estate tax applies only to an NRA’s U.S. property, not worldwide property. Still, an NRA who plans to invest in U.S. real estate or securities should invest through a foreign corporation or a foreign irrevocable trust to avoid the U.S. estate tax on U.S. situs assets on his or her death.

Review your estate plan to avoid U.S. estate and gift taxation on your investments.

NEW YORK UPDATE

INCREASE IN EXEMPTION AMOUNT

The New York estate tax exemption amount, currently \$4,187,500, is scheduled to increase to \$5,250,000 after April 1, 2017. This could result in significant estate tax savings for New York residents. For instance, if an estate is valued at \$5,250,000, the NYS estate tax liability would be \$1,062,500 if death occurs prior to April 1, 2017, but would be nothing if the death occurs after April 1, 2017. As illustrated with the increase in the federal estate and gift tax exemption amount, the increase in the New York estate tax exemption could mean significant estate tax savings for you.

Review your estate plan to ensure that assets are organized optimally to take advantage of the exemption increase.

TREATMENT OF GIFTS

New York law has changed regarding certain gifts made during a decedent’s lifetime. Prior law did not impose a gift tax on lifetime gifts and excluded such gifts from the New York gross estate. Under new law, gifts made within three years of a decedent’s death will be added back to the New York gross estate, and might therefore be subject to New York estate tax at a maximum rate of 16 percent. The add back does not apply to gifts made before April 1, 2014, after January 1, 2019, or during a time when the decedent was not a resident of New York State.

Consider creating a bypass trust to set aside and ensure the proper disposition of New York’s basic exclusion amount.

CONNECTICUT UPDATE

CONNECTICUT UNIFORM POWER OF ATTORNEY ACT

Changes to Connecticut's power of attorney law became effective on October 1, 2016. While existing powers of attorney remain valid, the new provisions spelled out in the Act may prove beneficial to you.

The updated law authorizes the use of a new "short form" power of attorney, which covers the basics, as well as a revised "long form" power of attorney, which allows for an expanded role. With the long form, principals are required to affirmatively "opt in" in order to give agents certain estate planning powers, such as amending or revoking a trust, making gifts above the federal annual exclusion amount and changing beneficiary designations.

Another new provision stipulates that powers of attorney remain in effect even if a principal becomes incapacitated. Under prior law, explicit language was required to ensure that a power of attorney would remain effective in such circumstances.

Update your power of attorney to benefit from the Act's new provisions.

HOLM & O'HARA LLP TRUSTS & ESTATES TEAM

These are just a few recent updates for your consideration. The Trusts & Estates Team at Holm & O'Hara LLP are prepared to discuss these and other concerns with you. Estate planning can be complex and overwhelming, but we will provide you with guidance as to how your estate plan can meet your goals both during and after your life.

We wish you and your family the very best and look forward to connecting with you in the coming months.

Michael L. Landsman, Esq. **Co-Managing Partner**

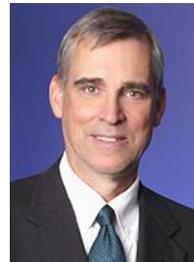
Mr. Landsman represents fiduciaries and beneficiaries, assisting with the administration of trusts and estates, including federal and state tax compliance. In addition, Mr. Landsman advises clients regarding estate planning strategies and legal approaches, particularly when commercial real estate is involved.



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