CUMMINGS & LOCKWOOD LLC

Six Landmark Square
Stamford, CT 06902
203.327.1700 Phone
203.351.4534 Fax

Two Greenwich Plaza
Greenwich, CT 06830
203.869.1200 Phone
203.869.3120 Fax

75 Isham Road, Suite 400
West Hartford, CT 06107
860.313.4900 Phone
860.313.4993 Fax

3001 Tamiami Trail North
Naples, FL 34103
239.262.8311 Phone
239.263.7032 Fax

8000 Health Center Blvd., Suite 300
Bonita Springs, FL 34135
239.947.8811 Phone
239.947.8025 Fax

11760 U.S. Highway 1, Suite 502W
Palm Beach Gardens, FL 33408
561-214-8500 Phone
561-214-8514 Fax

NOVEMBER 2019 CLIENT UPDATE

Dear Clients and Friends:

We are writing, 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.

Although no major changes occurred in the federal estate and gift tax laws in 2019, the past year saw significant estate and trust law changes at the state level, including sweeping trust law changes in Connecticut, new tax developments for real property transfers in Connecticut, Florida, and New York, and a favorable United States Supreme Court decision that limits states' ability to tax income of certain trusts. This update summarizes the current status of the estate and gift tax rates and exemptions at the federal and state levels and highlights key provisions of these important state law developments.

ESTATE, GIFT AND GST TAX RATES AND EXEMPTIONS FOR 2019 TO 2026

Federal Tax Exemptions

Consistent with the changes to the federal estate, gift and GST taxes that took effect in 2018 following the enactment of the Tax Cuts and Jobs Act of 2017 (the "2017 Tax Act"), the federal exemption from such taxes is $11,400,000 per person in 2019, and is scheduled to increase to $11,580,000 in 2020 when the annual 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 rate of 40% at the federal level. Because the gift and estate tax exemptions have been unified since 2011, this exemption can be used during lifetime or at death or some combination of both.

Although in general the increased federal estate, gift and GST exemptions can help make estate plans more tax efficient, existing plans should be reviewed carefully in light of the new exemptions if they have not already been reexamined to address any unintended consequences of the changes to the exemptions.

Should You Consider Accelerating Gifting to "Lock In" Higher Exemptions?

It is important to keep in mind that the 2017 Tax Act might be shorter lived than originally intended. The 2017 Tax Act that 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 further legislative action makes the changes permanent. With the 2020 elections on the horizon, there is always the possibility of a new tax law which could result in a more rapid return to pre-2018 levels and perhaps even lower exemptions. For this reason, we encourage clients who are concerned that the exemption amounts may be reduced in 2026 or sooner to discuss gifting strategies with their Cummings & Lockwood attorney now so a strategic plan can be designed and implemented well in advance of any reductions in tax-free gifting capabilities.

For our clients residing in Connecticut or considering gifting property located in Connecticut, it also is important to remember that state gift taxes must be taken into account before acting. For example, as discussed in more detail below, Connecticut's gift tax exemption will continue to be lower than the federal exemption until 2023, meaning gifts by Connecticut residents and gifts of Connecticut real estate by nonresidents before then might incur a state gift tax even if the gifts do not result in a federal gift tax.

Connecticut Finally Clarifies Estate and Gift Tax Exemptions

In 2019, the Connecticut estate and gift tax exemption increased from its prior level of $2,600,000 per person to $3,600,000. Although there was confusion as to what would occur in 2020 and future years because the Connecticut legislature enacted two conflicting bills with respect to the Connecticut estate and gift tax, that controversy has been resolved. Connecticut's 2020/2021 budget signed by Governor Lamont in June 2019 clarified that 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. In addition, as of January 1, 2019, the maximum amount an individual may be liable to pay to Connecticut in combined estate and gift tax is capped at $15,000,000.

Review and Current Status of Other State Estate Tax Laws

New York

On January 1, 2019, New York's estate tax exemption amount increased 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 does not reflect the increased federal exemption passed in the 2017 Tax Act but rather is $5,740,000 in 2019 and is expected to increase in 2020, although the increased amount has not yet been published.

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. In practical terms, this means that a New York estate valued at more than 105% of the exemption amount ($6,027,000 in 2019) would face estate tax on the entire value of the estate, rather than just 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. When considering such gifts, however, it is important to keep in mind that New York has reinstated its "look back" rule to bring gifts made within three years of death back into the estate for purposes of calculating the estate tax due.

<u>Twelve States and District of Columbia</u>
In addition to Connecticut and New York, 10 other states continue to have an estate tax, namely Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, 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. Connecticut remains the only state with a gift tax.

<u>Florida and Thirty-Seven Other States</u>
Florida does not have an estate tax, and the state constitution prohibits the legislature from enacting a Florida estate tax on residents. Likewise, the 37 other states not listed above also have no estate or gift tax. Nevertheless, anyone who owns property in the District of Columbia or in one of the 12 states listed above may be subject to state estate taxes at death.

MAJOR CHANGES TO CONNECTICUT TRUST LAWS

In July 2019, Governor Lamont signed into law a new Trust Code. This sweeping legislation enacted four separate Acts comprising four major categories of revisions to trust law, described in more detail in the sections below, that will alter the administration of trusts and provide additional planning opportunities for clients in Connecticut when the law takes effect on January 1, 2020.

<u>Self-Settled Asset Protection Trusts For Your Own Assets</u>
Asset protection planning for one's own assets historically involved complex, costly off-shore trust arrangements and was disfavored in most U.S. states. More recently, some U.S. states enacted domestic asset protection statutes allowing individuals to transfer their assets to a trust of which they were also a potential beneficiary in order to protect those assets from the their creditors. To take advantage of these arrangements, Connecticut residents had to hire professional trustees in other jurisdictions and faced uncertainty about whether Connecticut would respect the law of the other states if the trust creator was sued. With the adoption of the Connecticut Qualified Dispositions in Trust Act, beginning in January 2020, clients may establish a trust in Connecticut and be a beneficiary of that trust while protecting the trust property from certain creditors. Notably, the law only allows for future protection against certain creditors and there are certain "look-back" periods after funding during which some funds may not be protected from all creditors. Detailed technical requirements must be satisfied to fall within the statutory framework, but when prepared properly, these

trusts can be a powerful tool for clients to protect their assets akin to the protection afforded to business owners by limited liability companies.

Directed Trustee Trusts

Many clients struggle to select trustees of their trusts because the person who is best suited to handle distributions to beneficiaries may not be the most appropriate choice to make investment decisions and vice versa. By adopting the concepts of trust directors and directed trustees, the Connecticut Uniform Directed Trust Act provides a convenient way to address this problem. In essence, beginning January 1, 2020, Connecticut law will allow the bifurcation of trustee responsibilities between trustees and directors who can be given certain powers to direct trustees on certain issues that traditionally were the responsibility of the trustee. For example, a trust creator may now appoint a trustee who will be responsible for making distribution decisions, but will take direction from a specialized professional when making investment decisions. This new provision may prove useful for those who wish to place a closely-held business interest in a trust, but need a fiduciary with special skills to manage the business. It may also enable the trust to retain concentrated positions, whether securities or a business or real property, that a trustee otherwise might be unwilling to hold. Lastly, some may use a bifurcated structure to separate investment duties from distribution decisions if each of the individuals being appointed is better suited to one set of responsibilities than the other.

Dynasty Trusts to Last 800 Years

In another significant development, the Connecticut Uniform Rule Against Perpetuities Act permits the creation of Dynasty Trusts in Connecticut, which will allow trusts to continue through multiple generations. Prior to its enactment, the usual duration of a Connecticut trust was limited to roughly 110 years. As of January 1, 2020, the limit will be increased to 800 years, providing a significant opportunity for clients interested in multi-generational wealth planning in Connecticut. By funding a Dynasty Trust with assets that can remain exempt from estate tax and generation-skipping transfer tax for such a long duration, clients can transfer significant wealth to successive generations without erosion by transfer taxes. Connecticut residents interested in Dynasty Trust planning will no longer need to hire corporate trustees in other jurisdictions to use this strategy, which should appreciably diminish the cost of creating and maintaining Dynasty Trusts.

New Statutory Rules for Trust Administration and Trustee Procedures

The Connecticut Uniform Trust Code contains a number of other important guidelines for trustees and beneficiaries of Connecticut trusts, resolving ambiguities that had long plagued the State’s trust laws. The law imposes greater requirements to provide notice of the trust and its activities to beneficiaries, while also permitting the appointment of a representative to receive notice on a beneficiary’s behalf where appropriate. It also provides for greater flexibility for trustees and beneficiaries to adapt to changing circumstances by streamlining the process for obtaining Probate Court approval to change or terminate a trust, and gives trustees the flexibility and protection of seeking judicial pre-approval or nonjudicial settlement of certain trust matters. On the whole, these new rules provide much needed clarity on administration of trusts in Connecticut.

The new rules create many default provisions, including notice to beneficiaries and annual accounting requirements, which will automatically apply unless overridden by the trust documents. Trusts that become irrevocable before January 1, 2020 are not subject to these rules, but new trusts and trusts that become irrevocable after such date will be. If you are concerned about which rules apply to your trusts, please contact your Cummings & Lockwood attorney to discuss.

SIGNIFICANT STATE CHANGES TO REAL ESTATE TRANSFER TAXATION

Florida Broadens Exemption from Documentary Stamp Taxes for Married Couples

Prior to 2018, Florida's documentary stamp tax applied to transfers of real property between spouses if there was a mortgage or other debt on the property. A 2018 amendment referred to as the "newlywed exemption" created an exemption from tax for certain transfers between spouses of such encumbered homestead property, but only if the transfers occurred within the first twelve months of marriage. Effective July 1, 2019, however, Florida's legislature broadened this exemption to include any transfers of encumbered homestead property between spouses, no matter how long they have been married.

Connecticut "Mansion Tax"

Effective July 1, 2020, Connecticut will impose an additional tier of tax on real estate sales in excess of $2.5 million, colloquially referred to as the "mansion tax." Currently, the state levies a conveyance tax calculated on a graduated scale: 0.75% on the first $800,000 of the sale price and 1.25% on the portion of the sale price in excess of $800,000. The new law keeps the current structure, but imposes an additional rate bracket of 2.25% on any portion of the sale price in excess of $2,500,000.

For taxpayers who remain Connecticut residents following the sale, however, the law provides for some relief from this new tier of tax, in the form of an income tax credit equal to the amount of tax paid at the top rate. For tax years beginning on or after January 1, 2021, taxpayers will be eligible for the credit beginning in the third year after the year in which the conveyance tax was paid. The allowable credit in each year is equal to one-third of the amount of conveyance tax that was paid at the 2.25% rate. Given this structure, a taxpayer would have to remain a Connecticut resident for at least 6 years to recoup the entire "mansion tax" paid. Taxpayers may carry forward unused portions of the credit for no more than 6 successive tax years.

New York Adds "Progressive Mansion Tax" on Top of Existing Mansion Tax and Increases Transfer Tax

As part of the 2019/2020 New York State Budget Bill that was signed into law in April 2019, New York included a progressive mansion tax with a top tax rate of 3.90% on properties purchased for $25 million or more. This update to the already existing "Mansion

Tax," which imposes a 1% tax on buyers of properties that are purchased for $1,000,000 or more, implements a graduated scale that keeps the existing 1% tax rate for properties priced between $1,000,000 and $1,999,999, then increases up to a tax of 3.90% for properties purchased for $25,000,000 or more.

In addition to the Mansion Tax, New York also imposes a separate real estate transfer tax. Effective July 1, 2019, the real estate transfer tax increased from 0.4% to 0.65% for residential properties sold for more than $3,000,000 and for commercial properties sold for more than $2,000,000.

FAVORABLE SUPREME COURT RULING ON STATE INCOME TAXATION OF TRUSTS

In a unanimous decision in June 2019, the United States Supreme Court announced an important constitutional limitation on states' ability to tax the income of a trust based solely on the residence of the trust's beneficiaries. In *North Carolina Department of Revenue v. the Kimberley Rice Kaestner 1992 Family Trust*, North Carolina sought to tax a trust created by a New York grantor and administered by a New York trustee using a Massachusetts custodian, arguing that the North Carolina residence of the trust's beneficiaries alone justified its taxing the trust's income. The Supreme Court disagreed, holding that the residence of a beneficiary alone was an insufficient connection between the trust and the state to subject the undistributed income of the trust to state taxation.

Although *Kaestner* involved North Carolina's tax system, its implications extend more broadly. Five other states' statutes suggest that trusts may be taxed solely on the basis of a beneficiary's residence in the state, namely California, Georgia, Montana, North Dakota and Tennessee. If you are a trustee or a beneficiary of a trust that has been paying income taxes in any of these states, you should review the last few years of returns and determine whether the trustee should apply for a refund. As the law in this area evolves in light of this case, those states' tax systems may be called into question and more states may seek to change their basis for imposing income taxes on trusts. We will endeavor to keep you informed of further major developments, but you should always consult your Cummings & Lockwood attorney or the trust's tax advisor about the applicable state income tax rules for any trust of which you are the trustee.

CHANGES TO CONNECTICUT ESTATE TAX TREATMENT OF REAL ESTATE OWNED BY PASS-THROUGH ENTITIES

Connecticut's estate tax applies not only to residents but also to nonresidents who die owning real estate or tangible personal property located in Connecticut. Historically, nonresidents potentially might have avoided Connecticut estate tax exposure by transferring Connecticut real property into business entities such as LLCs, because ownership in a business, unlike direct ownership of the business's assets themselves, did not subject a nonresident to Connecticut estate tax. A recent tax law change that took effect in July 2019 has called into question the effectiveness of this strategy. Following the tax law's enactment, certain entities such as partnerships, S corporations or single member LLCs that are disregarded for federal income tax purposes may also be disregarded for Connecticut estate tax inclusion purposes following the death of a member of the pass-through entity. This means that Connecticut estate tax may be imposed on a nonresident member's proportionate real estate ownership interest under certain circumstances. The litmus test for whether an entity will be respected or disregarded is whether the entity exists for a "valid business purpose" rather than a tax planning purpose. While we wait for regulations to elaborate on what the legislature meant by "a valid business purpose," nonresidents with Connecticut property would do well to evaluate their particular circumstances.

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 70 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 press releases on our website, 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 planning and estate, gift and GST taxes. In addition, if you follow us on LinkedIn you can review posted updates through that site as well.

In this Update, we have deliberately simplified technical aspects of the law in the interest of clear communication. Under no circumstances should you or your advisors rely solely on the contents of this Update for legal advice, nor should you reach any decisions with respect to your personal tax or estate planning without further discussion and consultation with your advisors.

In accordance with IRS Circular 230, we are required to disclose that: (i) this Update is not intended or written by us to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer; (ii) this Update was written to support the promotion or marketing of the transaction(s) or matter(s) addressed by such materials; and (iii) each taxpayer should seek advice on his or her particular circumstances from an independent tax advisor.