

2023 CLIENT ADVISORY

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All of us at Blair & Potts wish you and your families health and happiness in 2023. January 4 marked the 30th anniversary of the date Arthur G. Potts, Jr. and Nancy E. Blair started the firm! We are thankful for the trust and faith our clients have shown in us to make this achievement possible and look forward to working with you for many years to come.

2022 was certainly an eventful and interesting year. COVID-19 moved further into the background which allowed many of us to return to our day-to-day routines. One of the buzzwords of 2022 was “inflation,” which increased costs for many household items, but may have a positive impact on our tax laws. The stock market was in tumult for most of the year as we entered a bear market not seen since the end of the Great Recession in 2008. The year ended with a federal mid-term election which no doubt will make the passage of significant legislation less likely.

As we look forward to 2023, we thought it would be helpful to provide a summary of various tax provisions which may be of interest to you and things you may wish to think about as you plan for the future.

2023 Changes to Tax Laws

Federal Tax Changes.

In 2023 the federal estate and gift tax exemptions increased to \$12,920,000 per individual (up from \$12,060,000). For clients who previously gifted their entire federal exemption, you now have an additional \$860,000 to gift.

As mentioned in past advisories, however, the Tax Cuts and Jobs Act of 2017, which made significant changes to the federal tax laws, including the doubling of the exemptions, is set to expire on January 1, 2026 unless legislation is passed making the changes permanent. If so, the federal exemptions will return to their 2016 levels (approximately \$6.5 million, as indexed for inflation, per individual).

Many other federal tax provisions were automatically adjusted for inflation in 2023. Below are some of the adjustments that may be of particular interest to you:

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	2022	2023
Annual Gift and GST-Tax Exclusion	\$16,000	\$17,000
IRA Contribution Limit	\$6,000	\$6,500
401(k) Contribution Limit	\$20,500	\$22,500
HSA Contribution Limits (single/married)	\$3,650/\$7,300	\$3,850/\$7,750

Finally, although the tax rates are the same in 2023 as in 2022, the thresholds for each marginal income tax bracket increased, which could result in an overall tax savings.

State Estate and Gift Taxes.

Several states still impose an estate or inheritance tax on persons who are domiciles of such states, or who own real estate or tangible personal property located there. The following states have an estate tax: Connecticut, District of Columbia, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersey, Oregon, Rhode Island, Vermont and Washington. In addition, Iowa, Kentucky and Pennsylvania have an inheritance tax based on the value of property passing to a particular class of beneficiary.

Connecticut remains the only state with a gift tax.

Therefore, when reviewing your estate plan, or creating a gifting program, careful thought must be given to any potential state transfer tax imposition or avoidance. For example, gifting a home in Connecticut would require using your Connecticut exemption, but gifting a home of equal value in Massachusetts would not reduce either your Connecticut or Massachusetts exemption and would therefore be a more effective gift from an estate and gift tax perspective.

Connecticut

Connecticut's estate and gift tax exemptions in 2023 now equal the federal exemption of \$12,920,000 (up from \$9,100,000). You may recall that, until 2023, Connecticut's exemption lagged the federal exemption with the result that clients, who otherwise wished to make gifts equal to their available federal exemption, limited their gifts to their available Connecticut exemption in order to avoid incurring a Connecticut gift tax. Those clients now have the opportunity to fully gift their available federal exemption without triggering a Connecticut gift tax.

New York

New York's estate tax exemption for 2023 increased to \$6,580,000 (from \$6,110,000). However, the New York estate tax remains a "cliff tax" which means that once the value of a person's New York taxable estate exceeds the New York exemption, the entire estate will be subject to the New York estate tax, not just the amount exceeding the New York exemption.

On a slightly more positive note, because New York does not tax lifetime gifts, New York residents may reduce their New York estate tax liability by making lifetime gifts. However, any taxable gifts made within three years of death are brought back into a person's estate for purposes of calculating any potential New York estate tax. To avoid this three year claw back, advance planning is critical.

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Other State Estate Tax Exemptions

Below are the 2023 estate tax exemptions for the remaining tax jurisdictions:

Taxing Jurisdiction	2023 Exemption
District of Columbia (projected)	\$4,594,000
Hawaii	\$5,490,000
Illinois	\$4,000,000
Maine	\$6,410,000
Maryland	\$5,000,000
Massachusetts	\$1,000,000
Minnesota	\$3,000,000
Oregon	\$1,000,000
Rhode Island	\$1,648,611
Vermont	\$5,000,000

As mentioned, some states have an inheritance or succession tax instead of an estate tax.

A word of caution to clients who own a second home or property in one of these states, whose value may be less than the applicable exemption for such state. Because of the somewhat complicated way that states compute a non-resident's estate tax liability, you may nevertheless be subject to state estate tax in that state. However, with proper planning such taxes can be avoided or minimized.

Planning for the Future

In determining what is right for you and your family, it is important to consider a number of factors, including the current tax uncertainty, the impact of state taxes in any state where you may own property, your personal financial situation and family circumstances.

Review of Existing Estate Plan.

Ideally, we recommend that you review your estate plan each year or, for those who may not be as attentive, anytime there is a significant life event such as a birth, death, marriage or divorce.

You want to ensure your plan still makes sense in light of changes to tax laws (including those described in this advisory) as well as to the rules governing the administration of trusts. For example, Connecticut, and many other states, have recently adopted laws which provide additional flexibility in the administration of trusts and extends the number of years a trust can exist. These new provisions can provide additional tax planning opportunities for you and your family.

Importantly, but sometimes overlooked, you want to be sure to also review whom you have named to critical fiduciary roles such as Executors, Trustees, Health Care Representatives and Agents under a financial power of attorney. With respect to any Powers of Attorney and Living Wills, signing updated documents may make it easier for your designated agents to use these documents at the appropriate time.

Gifts

Lifetime gifting to loved ones can be personally fulfilling as well as provide a significant tax benefit to you and your family, especially for those who may wish to take advantage of the current exemption amounts before they are rolled back in 2026 to their 2016 levels. A successful gifting strategy could include one or more of the following techniques which vary from simple to complex:

Annual Exclusion Gifts

The foundation of any gifting program is the effective use of your annual exclusion gifts. In 2023, you may gift \$17,000 (\$34,000 for couples) to any person. These gifts do not reduce your federal or state estate tax exemption and provide a valuable tool in minimizing your potential estate tax liabilities. Over a period of years, such gifts may reduce your taxable estate significantly. For clients who want to benefit loved ones who might not be responsible enough to manage outright gifts, trusts can be established which would provide management of the gifts (discussed below).

Tuition and Medical Payments

Direct payments of tuition (including private primary school, college, vocational, post graduate and professional schools) and medical expenses for any person, if paid directly to the institution, are not treated as gifts for transfer tax purposes. Therefore, you can increase the amount of assets that may be transferred in any year through these direct payments.

Intrafamily Loans.

Although interest rates are rising, parents may make loans to children at rates determined by the IRS that are generally more favorable than those offered by a commercial bank.

Family Trusts

If you are not comfortable making outright gifts (whether annual exclusion or larger taxable gifts), you may consider the advantages of creating a trust to manage and invest the gifts for the benefit of your descendants. The appreciation and future income on the gifted property would also avoid estate taxes at your death.

Moreover, a Family Trust may be structured as a grantor trust for income tax purposes so that all income and capital gains would be taxable to you on your personal income tax return during your lifetime, without the payment of taxes being considered an additional gift to the trusts.

The trust may also provide your descendants with some protection from the claims of marital, medical, financial or other creditors.

Dynasty or GST Exempt Trusts

For those interested in benefitting multiple generations, gifting to a multigenerational trust, or “Dynasty Trust,” allows you to remove assets not only from your estate but also from the estates of your children and grandchildren. Dynasty Trusts can be funded with your available generation skipping transfer (GST) tax exemption. In 2023 the GST tax exemption is \$12,920,000, but is scheduled to be halved in 2026.

Similar to a Family Trust, a Dynasty Trust also provides your descendants with protection from the claims of creditors and can be structured so that you, as the grantor, would pay any income tax attributed to the trust without it deemed an additional gift to the trust.

An important consideration when creating a Dynasty Trust is selecting the governing state law which determines how long a trust can remain in existence. Some states, such as Connecticut, allow trusts to continue for hundreds of years. Others, such as Delaware, can continue in existence indefinitely.

Spousal Lifetime Access Trusts (SLATs)

The trusts discussed up to this point require that you no longer have access to the gifted assets once they are transferred to the trust. A married person who desires to use the increased federal gift exemption, but wants to retain some level of control and access to the gifted property, may create an irrevocable trust for the benefit of his or her spouse and descendants, a so-called Spousal Lifetime Access Trust (“SLAT”). The transfer to a SLAT is a completed gift, and any remaining assets of the SLAT should not be included in either spouse’s estate for estate tax purposes. Each spouse could create a SLAT for the benefit of his or her spouse so long as the terms of each trust are not identical.

If you have already established a family trust, dynasty trust or SLAT, you may wish to consider topping off those trusts with your additional 2023 federal and/or Connecticut exemption.

Grantor Retained Annuity Trusts (GRATs)

A Grantor Retained Annuity Trust (GRAT) has been an especially effective method of transferring assets to descendants. A GRAT allows you to transfer property that you expect to appreciate rapidly, such as stocks or interest in closely held companies, to a trust while retaining the right to receive an annuity for a specified term of years. Current law permits the value of the property you are transferring to a GRAT to equal the value of your annuity payments, with the result that there is no taxable gift. These are sometimes referred to as

“zeroed-out GRATs”. 2022’s stock market decline may create a unique opportunity to fund a GRAT with undervalued stocks that have the potential to increase in value significantly over the next two years.

Perhaps as a testament to their effectiveness, zeroed-out GRATs have been the target of proposed—but as yet never passed—legislation intended to limit their use. Many commentators predict that limitations on GRATs would be a relatively non-controversial way for Congress to limit the tax free transfer of wealth. Therefore, many urge funding zeroed-out GRATs before any such legislation might be passed.

Other Trusts.

Depending on your situation other strategies may be implemented. In keeping with estate planners’ affinity for acronyms, clients who are charitably inclined, especially those who have highly appreciated assets, may wish to consider creating a Charitable Remainder Unitrust (CRUT) or Charitable Lead Annuity Trust (CLAT) which are split-interest trusts that benefit both your family and charity. For clients owning a vacation home that they hope to keep in the family, a Qualified Personal Residence Trust (QPRT) may be appropriate. We would be happy to discuss these techniques with you.

The next few years promise to be eventful for our friends and clients. All of us at Blair & Potts are here to assist you in any way we can. Please do not hesitate to call if you would like to schedule a meeting.