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TRUSTS & ESTATES ADVISORY

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Dear Clients and Friends,

As we enter the 2020s, we would like to focus your attention on a number of changes to federal and state laws that may impact your estate and retirement planning. The first section of this letter focuses on issues and opportunities created by changes in the federal, Connecticut and New York estate tax rules. Next, we examine major revisions to the Connecticut trust laws that became effective this year. The third section highlights estate and retirement planning changes under the SECURE Act which was passed in late December 2019.

Ever Changing Estate, Gift and GST-Exempt Amounts.

The federal and New York transfer tax exemptions, adjusted annually based on inflation, increased modestly for 2020. The federal exemption is now $11,580,000, increasing from $11,400,000 in 2019. The New York exemption is now $5,850,000, increasing from $5,740,000 last year.

In keeping with the goal of bringing the Connecticut exempt amount more in line with the federal exempt amount, the Connecticut estate and gift tax exemption increased much more dramatically, from $3,600,000 in 2019 to $5,100,000 for 2020. The Connecticut exempt amount will continue to increase in $2,000,000 increments for each of the next two years, after which the Connecticut exemption is expected to be in line with the federal exemption starting in 2023.

A continuing feature of the federal law allows the two exemptions of a married couple to be combined, through the concept of "portability," with the result that as much as $23,160,000 can be passed along during lifetime or through the estates of a couple without any federal estate or gift tax.

Unfortunately, Connecticut does not recognize portability. As a result, although the combined exemptions for a couple would be $10,200,000 in 2020, careful planning is needed to be certain that each exemption is used in each estate plan.

Not only does New York not permit portability, New York nullifies the benefit of the exempt amount if an estate exceeds the exemption by more than five percent. At one time, Connecticut had a similar "cliff tax" but the Connecticut cliff tax was eliminated a number of years ago. For New York residents faced with the potential of a cliff tax, not only is it important to plan carefully for use of the available exemption at death, but also to consider lifetime transfers to keep the estate below the cliff tax amount. New York does not impose a gift tax, but does apply a three-year lookback for gifts made between January 15, 2019 and January 1, 2026. Advance planning is therefore essential.

As a general observation, increased exemptions create opportunities for simplifying plans of estates expected to fall below the exempt amounts. To the extent those plans had previously focused on tax minimization, they can now focus on non-tax issues such as creditor protection for beneficiaries and efficient asset management. For very large estates, the estate tax remains an important consideration and more sophisticated strategies will continue to produce tax benefits that will generally offset increased complexity.

Those likely to benefit most from periodic reviews of their estate plans as the tax law changes would be those whose assets fall between the state exempt amount and the federal exempt amount where tax planning may be most needed to protect both tax and non-tax objectives.

Overhanging all of these issues is the possibility that both the federal and Connecticut exempt amounts may be reduced by roughly one-half if Congress does not extend the current law beyond 2025. With two presidential elections and three general elections between now and 2026, however, a "wait and see" approach may be the best course.

The annual gift tax exclusion amount remains at $15,000 for 2020. Annual gifts of up to $15,000 to any individual, whether a family member or not, generate no current gift tax and also have no impact on the larger gift and estate tax exemptions that can be preserved for larger transfers in the future. In a manner similar to portability, married couples can combine their exemptions so that one spouse can give up to $30,000 per recipient, provided similar gifts are not made by that person's spouse in the same year. In addition to annual exclusion gifts, individuals may also make gift tax-free transfers for another person's education or medical needs, with no dollar limitation, provided the transfers go directly to the school or medical provider.

In a related development, a new law in Connecticut clarifies that a non-resident of Connecticut will not be able to avoid the Connecticut estate tax on Connecticut real estate or personal property located in Connecticut simply by transferring that property to a pass-through entity. The new law specifically provides that an LLC, partnership or similar entity that might not otherwise be considered part of the estate of a non-resident will not be respected for Connecticut estate tax purposes unless the entity carries on a business for the purpose of profit, the ownership of the property was pursuant to a valid business purpose or the property was acquired by the entity for full consideration.

New Opportunities Presented by Changes in Connecticut Trust Laws.

Our Florida clients may be familiar with the Uniform Trust Code, enacted by Florida a number of years ago. On January 1, 2020, Connecticut joined Florida and over 30 other states in enacting its version of the Uniform Trust Code. Although in many instances the new law simply codifies existing law, in a number of important respects, the new law creates opportunities that had not previously existed under Connecticut law. While most beneficial provisions of the new law will automatically apply, a review of existing revocable trusts may be in order to take advantage of new opportunities that have now become available.

Of particular interest may be the opportunity to name "Trust Directors." In addition to naming a traditional trustee, a Distribution Director, who is not a trustee, can nonetheless direct the trustee as to when it is appropriate to make distributions to a beneficiary. Similarly, investment decisions can now be delegated to an "Investment Director." A "Special Asset Director" can be named to assume responsibility for the management of a family business where a traditional trustee would not be suited to play that role. While we do not believe that every trust will need trust directors, trust directors may be valuable in specific situations.

Creating trusts with long durations has been of interest to Connecticut residents for some time, but until January 1, 2020, the duration of such trusts in Connecticut was constrained by Connecticut's version of the "rule against perpetuities." Prior to the recent change, the longest period that trusts could continue would be perhaps one or two generations. Connecticut, however, has now effectively repealed these limitations by providing that trusts can continue for as long as 800 years. While it is unlikely that many clients will be interested in planning that extends out for eight centuries, for clients who would like to think in terms of more than just a few generations, such trusts will now be possible under Connecticut law.

The new law permits modification and termination of trusts on a much more open-ended basis than under prior laws. For clients who feel strongly that a trust should be protected against future changes, even ones that are approved by the trustee and all of the beneficiaries, it will now be necessary to make that intent clear in the trust document. Whether or not to limit the possibility for modification and termination is a new topic to consider in estate planning, particularly in light of the possibility for trusts of very long duration.

The new law significantly codifies a trustee's duty to keep a beneficiary reasonably informed about the operation of the trust, including an obligation to notify a trust beneficiary of the existence of the trust when the beneficiary reaches the age of 25. For clients who feel strongly that the details of a trust should not necessarily be shared with some or all of the beneficiaries, the new law allows for the designation of a representative to receive that information on behalf of the beneficiary. Because the basic obligations to inform the beneficiaries have been made mandatory for all irrevocable trusts coming into existence after January 1, 2020, the naming of a designated representative will now be essential for those clients who feel strongly that beneficiaries should not be given such information.

Under a separate provision of the new trust law, Connecticut now allows the creation of "asset protection trusts." An asset protection trust can be funded with a client's own assets, the client can continue to be a beneficiary of the trust and most of the client's creditors will not be able to reach the trust assets. Previously, it had been necessary to use the laws of other states in order to create asset protection trusts.

Finally, clients who have named three or more co-trustees should be aware that the new law requires only a simple majority of them to act. Under prior law, trustees, unless otherwise indicated in the trust document, were required to act unanimously. In most plans, majority rule is an appropriate arrangement. If, however, it is important that all trustees act together, that direction would now have to be expressly stated in the trust.

Retirement Planning Under the new SECURE Act.

The SECURE Act was passed on December 20, 2019 and became effective January 1, 2020. Almost all of the provisions of the SECURE Act are generally favorable.

From an estate planning point of view, however, the change most planners regard as not beneficial is the elimination of the opportunity for a non-spouse beneficiary of IRAs inherited after December 31, 2019 to stretch the distribution of the account over the beneficiary's lifetime. As modified by the SECURE Act, distributions to such beneficiaries, with a limited number of exceptions, must be completed no later than the end of the tenth year following the IRA owner's death.

Accelerating distributions will have a number of negative impacts including accelerating income taxes paid by the beneficiaries into a much earlier time period, when the beneficiaries may be in higher tax brackets, and significantly reducing the time available for tax sheltered investing in the account.

No change in the law has occurred with regard to payouts to spouses. For clients who name children or descendants as the contingent beneficiaries, no change may be needed, although note should be taken of the more rapid payout. For clients who have emphasized the concept of the stretch IRA by including trusts or other arrangements for grandchildren or other beneficiaries, revisions to the plan may be called for.

The SECURE Act also increases the age that the account owner must start taking minimum required distributions. In general, the starting date is extended to the year in which the account owner reaches age 72, rather than age 70 ½ under prior law. For clients who had already reached the age of 70 ½ by December 31, 2019, the law does not make any changes with regard to continuing required minimum distributions. For individuals who had not reached the age of 70 ½ prior to December 31, 2019, the new age 72 will apply.

A further beneficial change is an increase in the number of individuals who can make contributions to traditional IRAs. Under the prior law, individuals could not make contributions to IRAs after reaching age 70 ½ or during the year in which they turned age 70 ½. The SECURE Act eliminates any age limitation but leaves in place other income and compensation limitations regarding contributions to traditional IRAs.

Closing Thoughts

We encourage all of our clients to review their estate plans on a regular basis. While we can help you to understand the opportunities and challenges presented by changing laws that apply to the technical tax and administrative aspects of your plan, we cannot always know about changes in your circumstances, both financial and personal. A periodic dialogue, while not always resulting in any necessary changes, does facilitate keeping your estate plan current in a world of constant change.

With best wishes for the 2020s.

Your friends and advisors at Blair & Potts.

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