



How to Make The Most of the Federal-State Disconnect on Gift & Estate Taxes

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Finally –

**Certainty in
gift & estate tax.....**

**[American Taxpayer Relief Act became law in
2013, making “permanent” the estate tax law
changes expiring 12/31/12]**



**As certain as anything that's
subject to Congressional power
to change the rules—
retroactively!**



How Did we Get Here, and Where Are We?

Federal Estate Tax Exemptions and Rates

2001	\$675,000	55%
2009	\$3,500,000 (\$1,000,000 gift tax exemption)	45%
2010	No estate tax	
2011-2012	\$5,000,000 (for estates <u>and</u> gifts)	35%
2013	\$5,250,000 (for estates <u>and</u> gifts)	40%



How to Double the Federal Exemption

Take advantage of the portability rule: Executor of first spouse* to die must file a federal estate tax return on a timely basis

Result: If the first spouse to die leaves everything to the surviving spouse, the latter's estate tax exemption can be \$10,500,000.

*Now including married gay couples



Less than 1% of the U.S. population (may be as little as 0.14%) pay federal estate or gift tax

So, who cares about estate and gift taxes anymore?



If you live in New York or New Jersey, YOU should care.

New York

Exemption amount is only \$1 million.

No portability

Maximum tax rate 16% (starts at 5.6%)

New Jersey

Exemption amount is \$675,000 from estate tax. (NJ also has an inheritance tax!)

No portability

Rate: 4.8% - 16%



What Does this Mean?

If you die a resident of New York or New Jersey with \$5MM in your estate, leaving all to children, the estate will owe \$391,600 in state estate tax



What Can You Do?

1. **Move**
2. **Give it away.**
(New York and New Jersey have no gift tax and use an old federal state tax credit formula. This is the major cause of the “disconnect.”)



Examples (NY/NJ)

- 1. You make lifetime gifts of \$1MM, leaving your estate with \$4MM instead of \$5MM.**

State estate tax is reduced from \$391,600 to \$280,400.

- 2. You make lifetime gifts of \$4MM, leaving your estate with only \$1MM.**

State estate tax is reduced to \$33,200.

Caveat: NJ applies inheritance tax to gifts within 3 years of death. Inheritance tax reduces NJ estate tax.

Connecticut has gift tax on cumulative gifts over \$2MM.



3. What if you don't want to move or give it away?

- **If your estate, combined with your spouse's estate, is between \$1MM and \$2MM, a credit shelter trust in your wills reduces NY estate tax to a minimum.**
- **If your estate, combined with your spouse's estate, is between \$2MM and \$5.25 MM, a credit shelter trust and a NY QTIP trust *in your wills can defer NY tax until the second death.**

The deferred tax amount could be up to \$200,000.

***NJ law may not permit this.**



4. Spousal Lifetime Access Trust.

If you like New York (or New Jersey) and expect to have an estate over \$2MM (\$1.35MM if you live in New Jersey), after lifetime gifts, you need a SLAT to minimize state estate taxes.

SLATs have been called “the estate plan of the future.”



A SLAT is an

- **Irrevocable trust**
- **Set up during your lifetime**
- **To which assets are transferred during your lifetime**
- **Benefiting your spouse and/or children**



To make it work:

- **Independent Trustee**
- **Not identical to spouse's SLAT (reciprocal trust doctrine)**
- **Does not qualify for marital deduction**
- **Leave outside of SLAT assets not exceeding state exemption amount (but gifts to SLAT can be made gradually)**
- **Need good relationship with spouse (or children)**



Non-Tax Advantages of SLAT

- **ensures property goes to children/heirs after death of second spouse**
- **protects assets from your creditors and beneficiaries' creditors (e.g., your future ex-son-in-law)**
- **avoids probate—especially if retained assets are in joint account (but you should have a will in case assets are missed)**



Disadvantages?

- **Administrative difficulty**
- **Expense**
- **Loss of step-up in basis
(keep highly appreciated assets out of SLAT)**
- **Loss of tax benefits of home ownership (keep
out of SLAT, especially if sale planned)**

**Note: Purchase of small life insurance policy to pay state estate
tax increases flexibility in planning with a SLAT**



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