LESHKOWITZ LAW, PLLC

45 Broadway, Suite 3010
New York, NY 10006
Tel 212 248 0880
Fax 212 248 0999
www.leshkowitzlaw.com

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HAPPY NEW YEAR! – PLANNING CONSIDERATIONS FOR 2014

Last year at this time we were recuperating from the frenzied pace of estate tax planning in anticipation of expiring tax laws. After nearly a full year of stability on this front, we wanted to alert you to some recent developments and estate and gift tax planning opportunities to consider in 2014.

Federal and New York State Facts and Figures.

- Federal Gift and Estate Taxes. The unified Federal gift and estate tax exemption for U.S. citizens or residents is $5.34 million in 2014, a $90,000 increase from last year. The rate of tax for estates and gifts in excess of the exemption remains 40%. (The same exemption and rate applies to the generation-skipping transfer (GST) tax.)

- New York State Estate and Gift Taxes. New York State's estate tax exemption amount remains fixed at $1 million for 2014. New York still does not have a gift tax, which means that lifetime gifts can significantly reduce the amount of the eventual estate taxes. Of course, the advisability of such gifts must be weighed against other considerations including the loss of access to assets and the income tax basis step-up for assets passing at death. Last December the New York State Tax Relief Commission (appointed by Governor Cuomo) recommended increasing the New York State estate tax exemption to equal the Federal exemption.

- Annual Gift Tax Exclusion. The annual gift tax exclusion amount remains $14,000 per donee in 2014, or $28,000 per donee for gifts by married couples who elect "gift-splitting." With careful planning, trusts with multiple beneficiaries can be used for large gifts that pool annual gift tax exclusions.

- Gifts to Non-citizen Spouse. The annual gift tax exclusion for gifts to a non-citizen spouse is $145,000 this year. Gifts to non-citizen spouses are fully taxable except to the extent of the special annual gift tax exclusion or

available gift tax exemption. The annual exclusion allows significant asset transfers to a non-citizen spouse over time if desired.

- QDOTs No Longer Necessary for More Modest New York Estates. Under current law, bequests to a non-citizen spouse are subject to estate tax (subject to available estate tax exemption) unless the property is held for that spouse in a "qualified domestic trust" (QDOT), which allows for deferral of the estate tax until the surviving spouse's death (subject to certain caveats). QDOTs, however, are burdensome, complex and expensive to administer. Because the New York estate tax exemption is so much lower than the Federal exemption, some estates will require a QDOT to defer the New York estate tax even though they are not subject to estate tax at the Federal level. Last December, New York eliminated the QDOT requirement for estates that are not required to file a Federal estate tax return so long as the disposition would have qualified for the marital deduction had the spouse been a citizen.

Review and Update Estate Plan to Account for Recent Gifts.

Individuals who made large gifts during the last few years as the gift tax exemption has increased should review their estate planning documents to ensure that those documents still reflect their wishes, achieve the desired tax results and do not result in unintended tax.

Another area requiring attention is the allocation of the GST exemption to lifetime gifts. Clients increasingly are using GST exemption for multi-generational planning by making gifts to long-term trusts, including "dynasty" trusts that potentially can last forever. All transfers to trusts should be carefully reviewed with respect to the allocation of GST exemption. Inadvertent allocation of exemption to transfers not intended for the donor's grandchildren or more remote descendants wastes valuable GST exemption. Conversely, failure to allocate exemption properly can result in an otherwise avoidable imposition of the tax.

Use Grantor Retained Annuity Trusts ("GRATs").

In the continuing low interest rate environment, GRATs remain a valuable estate planning tool. GRATs can be structured to allow the transfer of appreciation in value of an asset at no gift or estate tax cost. The only estate tax risk to a GRAT is the grantor's death during the trust term, in which case the assets of the GRAT are

(typically) includible in the grantor's taxable estate. Under current law, the mortality risk may be minimized by creating GRATs with terms as short as two years.

Sell Assets to Grantor Trusts.

Similar to a GRAT, a sale of assets to a grantor trust allows the future appreciation in value of the transferred assets to escape gift and estate tax. A sale can be accomplished using a promissory note to pay part of the purchase price, which is repaid over time from the earnings of the purchased asset. So long as the payment from the trust is equal to the value of the asset purchased, the sale transaction is not subject to gift tax because the grantor receives full payment.

Typically, the interest rate on the promissory note will be set at the minimum IRS interest rate necessary to avoid a gift loan based on the loan term. These rates remain historically low. If the asset that is sold appreciates in value at a greater rate than the loan interest rate, the excess appreciation passes free of gift and estate tax.

Reacquire Low Basis Assets from Grantor Trusts.

Individuals who have transferred low-basis assets to a grantor trust and have seen those assets appreciate significantly in value may wish to consider swapping the appreciated assets for cash or property with a higher basis, in order to lock in gains and recover the low basis assets so that they eventually benefit from a step-up in basis at death. An asset swap with a grantor trust can be achieved without income tax consequences to the grantor or the trust.

We are available to advise our clients about any of the above-described strategies, or to discuss any other estate planning matter.

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