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March 14, 2018

Dear Clients and Friends:

The Tax Cuts and Jobs Act of 2017 (the "Act") brings significant changes to the federal income, gift, estate and generation-skipping transfer ("GST") taxes. The changes present new opportunities to structure wealth transfers and allocate income among individuals and entities in tax-advantaged ways.

Federal Estate, Gift and GST Tax Provisions

The Act doubles the basic lifetime applicable exclusion amount for federal estate, gift and GST tax purposes to $10,000,000 (from $5,000,000 under prior law). As under prior law, the Act provides for annual inflation adjustments to these exemptions, though using a slightly different method than under prior law. The IRS recently confirmed that the 2018 exemptions will be $11,180,000, or nearly double the $5,600,000 figure that would have applied under prior law.

As was the case with the Bush era tax cuts, the Act includes a "sunset" provision that causes nearly all of the non-corporate tax law changes to expire after 2025. Thus, absent further legislation, in 2026 the exemption amounts under the federal estate, gift and GST taxes will revert to $5,000,000 (with inflation adjustments from 2011).

The Act did not increase the base amount of the annual gift tax exclusion ($10,000), but it kept in place the annual inflation adjustments that have applied since 2011. By virtue of the inflation adjustments for 2018, the gift tax annual exclusion is set at $15,000 per donee – or $30,000 per donee for married couples who elect to split gifts. The expanded annual exclusion for gifts to a non-U.S. citizen spouse will be $152,000.

Clients whose estates exceed the increased exemption amount and whose lifetime gifts to date equal or exceed the pre-Act exemption amount ($5,490,000) may consider making further gifts to utilize the additional exemption before its scheduled expiration (December 31, 2025). Clients who pursue this tactic should be aware of the possibility, however remote, of future federal legislation designed to recapture the tax so avoided.

Clients whose Wills dispose of a share of the estate equal to the federal or state exemption amount should consider whether the increased exemptions under the Act and under state law (see below) will distort the intended disposition of their estates.

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Income Tax

Despite pronouncements from proponents of the Act, tax professionals perceive little simplification to the income tax system as a result of the Act. In addition, the promised tax savings of the Act will depend on each taxpayer's specific circumstances. There are still seven income tax brackets for individuals, 10%, 12%, 22%, 24%, 32%, 35% and 37% (down from a top rate of 39.6%), with the top rate applying to taxable income over $500,000 for those filing as single or head of household; over $600,000 for those filing as married filing jointly; and over $300,000 for married persons filing separately. The Act provides for inflation adjustments to the amounts delineating each tax bracket.

The standard deduction has been almost doubled (to $12,000 for single filers, $18,000 for a head of household, and $24,000 for married couples filing jointly) and is now subject to future inflation adjustments, but personal exemptions are eliminated, and opportunities for itemized deductions have become more restrictive.

Only $10,000 of state and local income, sales and property taxes may be deducted. The deduction for mortgage interest is limited to $750,000 of new debt, and home equity loan interest is deductible only if the loan is used to buy, build or substantially improve a residence. Deductions which have been eliminated include (i) alimony payments under divorce settlements signed after 2018, and (ii) any miscellaneous itemized deductions which were subject to the 2% adjusted gross income ("AGI") floor.

There is some good news on the deduction front. First, the 50% of AGI deduction limitation for cash contributions to certain charities (such as churches and colleges) has been increased to 60% of AGI. In addition, the Act eliminated the so-called "Pease limitation" on itemized deductions (which offset their tax benefit to the taxpayers in the higher tax brackets).

The Act has revised the taxation of young children's unearned income (*e.g.*, interest, dividends, and capital gains). To discourage the shifting of income from parent to child, the so-called "Kiddie Tax" originally taxed a child's unearned income above $2,100 at the top marginal rate of the child's parent. The Act now taxes the net unearned income of a child at the rates applicable to trusts and estates (which generally pay tax at higher rates than individuals). This appears to revive the opportunity for parents already at or near the top tax bracket to take some advantage of the child's lower tax rates.

The Act retains the alternative minimum tax ("AMT") but increases the exemptions from its applicability and the phase-out levels for applicable exemptions. The amounts delineating each AMT tax bracket are indexed for inflation.

Family-Owned Entities

Previously, the income of a partner, S-corporation shareholder or sole proprietor from his or her partnership, S corporation or sole proprietorship would generally have been taxed at his or her individual rates. The Act allows a deduction of up to 20% of qualified business income ("QBI") to such individual partners, shareholders and sole proprietors, and the deduction also applies to qualified REIT dividends and qualified publicly traded partnership income. The Act contains many technical rules that restrict the benefits of this provision. For example, the deduction for income from specified activities like law, accounting, and financial services is limited. Nevertheless, consideration of tax-advantaged business ownership structures will merit careful attention.

Separately, in the latter half of 2017, the Treasury announced the withdrawal of proposed regulations under Code Section 2704 which would have significantly restricted the ability to claim valuation discounts for partial interests in family-controlled entities.

New York Estate Tax Developments

New York's estate tax exclusion is currently $5,250,000, with increases being phased in until 2019, when the general sense was that it would match the federal exclusion. Now that the federal exclusion has doubled, it is worth clarifying that, beginning in 2019, New York's exclusion will continue to be based on the pre-Act $5,000,000 inflation-adjusted federal exemption amount.

Connecticut Estate and Gift Tax Developments

Prior to the passage of the Act, Connecticut amended its estate and gift tax statutes to increase the exemptions from such taxes. As written, the new state legislation increases the estate and gift tax exemptions to $2,600,000 for 2018 and $3,600,000 for 2019 and provides that for 2020 and future years the exemptions will equal "the federal exemption amount." Because the enactment of the Connecticut legislation preceded the passage of the Act, it remains to be seen whether the Connecticut legislature will leave the law unchanged and permit the Connecticut estate and gift tax exemptions to equal the much higher post-Act federal exemptions.

Interest Rates

The IRS-prescribed interest rates affecting intra-family transfers have begun to increase after years at or near historic lows, but they still remain relatively low. Certain estate planning techniques (such as intra-family loans and grantor retained annuity trusts) work most effectively when interest rates are low, while others (such as qualified personal residence trusts) provide greater tax savings when interest rates are higher. Opportunities

unique to lower rates remain viable and strategic decisions about which techniques to employ and when to employ them require consideration of these rates.

Corporate Taxes

With all the attention tax reform has gotten, no treatment of the Act would be complete without mention of the reduction of the corporate income tax rate to 21%. Unlike the Act's other changes addressed in this letter, the reduced corporate tax rate is not scheduled to expire after 2025. Perhaps its greatest significance in the estate planning context will be in the investment arena where, with the help of other professional advisors for our clients and friends, strategies (such as the interest rate-sensitive ones mentioned above) can be enhanced.

Conclusion

The professionals at the Firm look forward to opportunities to address your questions about this letter, other recent developments and estate planning strategies.

Sincerely,

DAVIDSON, DAWSON & CLARK LLP