New York City

Position your assets to shield appreciation from estate tax

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During the fiscal cliff negotiations at the end of 2012, we encountered a high volume or owners seeking to sell their properties prior to the New Year due to the increase in federal capital gains tax (from 15% to 20%), and also several owners transferring ownership into the name of a trust. The later was due to the fact that the estate tax exemption was set to expire at that time and there was a high level of uncertainty on whether it would be renewed or not.

For 2016, the federal estate tax exemption for individuals is $5.45 million and for married couples is $10.9 million. The exemption levels for New York State are currently $4.187 million for an individual and $8.375 million for married couples. It should be noted that the New York State exemption should match the federal by 2019 and both exemption levels are typically adjusted annually for inflation. Furthermore, the New York State exemption has a wrinkle involved in which an estate tax cliff will take place in the event the total value of the estate exceeds 105% of the exemption, in which the exemption is essentially eliminated.

Where this is important for property owners is with respect to shielding future appreciation of your portfolio from these taxes. Most property owners are very familiar with the use of LLCs; however the LLC alone does not provide any benefit with respect to estate tax. When an owner passes away (assuming both owners pass away if a married couple), their entire estate is valued and the net value that exceeds the above referenced exemption levels is taxed at 40% on the federal level and up to 16% on the state level. For example if the owners (married) were to pass away in 2016 and the net value of their entire estate is $20 million, $9.1 million will be taxed at 40% by the IRS and $20 million will be taxed at varying rates up to 16% by New York State (due to the estate tax cliff rule). This results in a total estate tax of $5.255 million. In planning for your estate, all property owners should consider gifting some of their assets to a trust for the benefit of their heirs. This method shields all future appreciation of those assets from estate tax of the current owner(s). It should be noted that there is no estate tax due, regardless of the value of the estate, on the sum that one spouse will inherit if only one of the two were to pass away.

Take the same owner who currently has a net worth of $20 million; that owner can take advantage of their entire estate tax exemption while living by gifting a sum of their assets equal to the estate tax exemption levels. For conversational purposes, let's fast forward to 2019 when the New York State and federal levels are the same. We would transfer $10.9 million of assets to an irrevocable trust or to the heirs individually. Thus the owner's net worth as of that moment would be $9.1 million as opposed to $20 million. Let's say the owners live another 10 years after the date of the transfer and the $10.9 million they transferred appreciates by 40% and at the time of death those assets are worth $15.26 million. What we accomplished is that we shielded the assets' appreciation of $4.36 million from the estate tax. That is a net savings of approximately $2.163 million. At the time of death, the only sum that would be subject to the estate tax is the $9.1 million of which the deceased maintained ownership as well as the appreciation of those assets. As you can see, this structure can result in a substantial savings in estate tax and something that everyone should take into consideration in properly planning for their estate.

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