TAX AND TRUSTS & ESTATES UPDATE

February 2016

2016 Gift Tax Reminder

Gift tax returns can be an important part of your yearly tax return filing responsibilities. Form 709 (United States Gift (and Generation-Skipping Transfer) Tax Return) is filed on a calendar-year basis and is due April 15th of the year following the year in which the gifts were made (unless an effective extension applies). As you determine whether or not you are required to file a gift tax return for 2015, consider the following frequently asked questions:

How much can I give without having to file a gift tax return?

An individual donor is entitled to an annual exclusion from federal gift tax on total gifts made in 2015 of up to $14,000 per donee. While some tax exemptions increase from year to year based on inflation, the gift tax exemption has remained constant since 2013. Nevertheless, there is no limit on the number of annual exclusion gifts that can be made to different donees in any year. For example, if you have three children, you (and anyone else) can give each of them $14,000 in 2015 and not have to file a gift tax return. In addition to the available annual exclusion gifts, certain qualified education expenses and medical expenses (paid directly to the institutions or providers, as applicable) are not subject to federal gift tax and do not reduce other available exemptions.

What kinds of gifts would not qualify for the annual exclusion?

Total gifts to any donee in excess of $14,000 will require a 2015 gift tax return to be filed. And bear in mind that only gifts of "present interests" qualify for the annual exclusion. Outright gifts (such as cash given directly to an individual) are gifts of present interests, but gifts to trusts that do not include what are known as "Crummey" withdrawal powers for beneficiaries often are not. And even gifts to trusts that include Crummey powers should be reviewed to ensure that a return is not required – often in order to allocate federal Generation Skipping Tax ("GST") exemption to those trust gifts. The GST tax is a federal tax imposed on transfers of wealth to individuals that the IRS considers to be two more or more generations below that of the donor (for example, a gift from a donor to his grandchild) and needs to be taken into account when considering whether a gift tax return should be filed and how to report generation-skipping gifts.

My spouse and I both have annual exclusions - so we can transfer $28,000 to a donee and not have to file gift tax returns?

If each of you and your spouse makes a separate gift of $14,000 from his or her own separate assets, that is correct. But the IRS also allows "gift-splitting". That can occur when one spouse makes a gift of (for example) $28,000 to an individual. If the donor's spouse consents, he or she can "split" that gift, so that each is deemed to be making a gift of only $14,000. In that way, the split gift does not exceed the annual exclusion amount for either spouse. However, gift splitting will require a gift tax return to be filed to record the split and the spousal consent. And gift-splitting will then generally apply to all gifts made by either spouse in that year.

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Will I have to pay gift tax?

You will be required to pay gift tax only if your aggregate taxable gifts in prior years plus your 2015 gifts exceed the amount of the gift/estate tax exemption available to you in 2015. That exemption was $5,430,000 in 2015. If, for example, you have made $3,000,000 of taxable gifts after January 1, 1977 (and no taxable gifts before that date), you used up $3,000,000 of your exemption, but you would still be able to make taxable gifts (i.e., gifts that do not qualify for the annual exclusion or any applicable deduction) in 2015 of $2,430,000 and still not have to pay gift tax. For 2016, the exemption is increased to $5,450,000.

What deductions are available?

Regardless of amount, outright gifts to your spouse or to qualifying charities qualify for deductions from the gift tax. In fact, if you made outright gifts in 2015 only to your spouse or to qualifying charities, you will not have to file a gift tax return. The only exception would be if you transferred less than 100% of an asset to a charitable organization (e.g., half of a residence property). And if you made gifts to qualifying charities in 2015, you should talk to your accountant about whether or not such gifts are deductible on your individual income tax return. Further, note that when a gift tax return is required to be filed, you should consider reporting all gifts, including charitable gifts.

Are there any other reasons to file a gift tax return?

Suppose you made a $14,000 gift in 2015 to a trust that included a "Crummey" withdrawal provision. Assuming notice was provided to the beneficiary of that trust, that gift would qualify for the annual exclusion, so a gift tax return would not need to be filed. But suppose that trust is intended to last for multiple generations but does not qualify for automatic allocation of your GST exemption. In that case, you may want to file a timely gift tax return to allocate your GST exemption to that gift. Or, if that trust is not intended to last for multiple generations but fits the IRS definition of a "GST Trust" so that your GST exemption is automatically allocated by statute, you will likely want to file a gift tax return to "opt out" of automatic allocation – for that gift and for future gifts to that trust – to ensure that your GST exemption is not wasted.

For example, a common trust that holds life insurance on your life and provides a trust for your spouse after your death and a further trust for children after your spouse's death but is expected to completely distribute the trust assets to your children during their respective lifetimes fits the IRS definition of a "GST Trust". As a result, any contribution to that trust will have GST exemption automatically allocated to it unless a gift tax return is filed to opt out of that allocation.

Moreover, even if automatic allocation of GST exemption is desired and useful, filing a gift tax return can help keep track of what amount of exemption was automatically allocated and when.

You must also file a gift tax return to report a gift to fund any Grantor Retained Annuity Trusts (or GRATs) that you created during 2015. A GRAT is a type of trust which pays its grantor an annuity for a specific number of years. At the end of that "term of years", everything in the GRAT could then be distributed to the grantor's children or go into trusts for their benefit. A taxable gift occurs when the GRAT is created (there is no further taxable gift when the annuity term expires). That gift is the difference between the value of the assets contributed to the GRAT and the present actuarial value of the grantor's retained annuity interest. In most cases, this amount is actually zero – but still needs to be reported. And it may also make sense to report the beginning and end of the estate tax inclusion period (ETIP) for a GRAT which benefits a remainder trust (or, in some cases, other trusts) whose ultimate beneficiaries are individuals two or more generations below that of the donor. Often at the end of the ETIP period, a gift tax return "opting-out" of the automatic GST exemption allocation is required.

Also, if you made a gift of assets that are difficult to value or for which you took a valuation discount, you may want to file a gift tax return to begin the running of the statute of limitations period. If no return is filed, the IRS has an unlimited amount of time to challenge the value of that gift. If a

The Uniform Trust Code is Coming to New Jersey…More to Follow

These new trust laws will broadly impact the administration of New Jersey trusts. Over seven years after it was first introduced in the legislature, the Uniform Trust Code (the "UTC") was signed into law last month. The aim of the UTC is to codify the law of trust planning and administration to provide clarity to trustees, trust beneficiaries, and trusts and estates practitioners. The law takes effect in July but will apply to all New Jersey trusts, whether created before or after the effective date. Accordingly, it will impact all clients with new or existing trusts.

Many of the UTC's provisions codify existing law, but others will alter the rights and obligations of trustees and beneficiaries. Some aspects of trust administration the UTC touches on include the effect of giving a third party the power to direct the investment of trust assets and the procedures available to trustees and beneficiaries to modify or terminate an irrevocable trust. Most importantly, the UTC imposes an obligation on trustees to notify beneficiaries regarding certain aspects of a trust's administration. As the effective date of the UTC approaches, we will be providing more detailed guidance on what may be required in the administration of New Jersey trusts to comply with the new rules. However, if you have any questions in the meantime about how the law may apply in your situation, please feel free to call us.

return is filed and the gift (and its valuation) is adequately disclosed, the IRS has only three years from filing (in most cases) to challenge the value of that gift. Even a sale transaction (e.g., a sale of assets to an intentionally defective grantor trust) might be appropriate to report on a gift tax return, so that – after the statute of limitations has run – the IRS cannot revalue the assets sold and assert that part of the transaction was a gift.

The Nonprofit Forum

This is the first in a series of articles on nonprofit organizations and issues that we will feature in our regular Updates. We have found this area to be one of ever-increasing interest to our clients and colleagues, and we hope you will find these articles helpful and insightful.

Nonprofit Board Membership – Some Thoughts for Future and Current Board Members

American nonprofit organizations have been great contributors to the collective good on local, national and international levels. The extent of American philanthropy has historically been quite impressive, and the people who have funded, and who work within, those organizations can take great pride in the good work that they accomplish.

It's certainly flattering, then, to be asked to be part of the governing board of an organization that is contributing to the public good. That being said, it's not an endeavor that should be entered into lightly. Any board member or prospective board member is encouraged to consider the following:

--Are you committed to the organization's mission (the organization should be able to articulate its mission to you), and are you willing to dedicate your time and effort to accomplish that mission? If you're not prepared to make that commitment, then it's best to step aside for someone who is. And if the organization cannot really describe its mission, that's a warning sign, too.

--If you are prospective board member, have you done some research on the organization through Guidestar or other publicly-available means where you can get the annual IRS forms 990 or 990PF for the organization (and often other helpful information)? And if you already serve on the board, you should expect this information to be provided to you at least annually. Basic information regarding officer salaries and other expenditures that can be the subject of scrutiny by the IRS and by the Attorney General of the state where the nonprofit operates should be shared with you.

--If you are a current board member, is the board allowed the opportunity, at least annually, to confer with the organization's attorneys, accountants, and auditors without corporate officers present? Transparency is the key to a safe and effective nonprofit operation.

--Do you have an economic relationship (even indirectly) with the organization as a vendor, service provider, etc.? At the very least, that arrangement should be disclosed. And certain arrangements may give rise to tax sanctions that can be imposed upon not only the organization, but also the board member.

As a board member, you should keep in mind that all you do in that capacity you do as a fiduciary, and subject to the high standard of care and diligence that applies to fiduciaries.

Finally, and consistent with the overarching objective that nonprofit activities and resources are for the ultimate benefit of the public, you should assume that all you do and say within the confines of the nonprofit organization will be subject to public scrutiny.

As a nonprofit board member, you have the opportunity to do your part to further the good purposes of these organizations, most of which are operated with the best

Sherman Wells is pleased to announce the election of Tracy McSweeney Child to Partner. Tracy has been Counsel with the firm since its inception in July 2014.

Tracy serves as the head of the New York office and practices in the firm's Tax, Trusts & Estates Group. Tracy counsels clients on a wide variety of estate planning, estate administration and closely-held family business matters, including, among other things, lifetime and testamentary wealth preservation strategies, business succession plans and philanthropy. She meets with individuals, their families and their financial advisors to implement a customized wealth preservation plan, taking into consideration estate, gift, generation-skipping tax, and income tax ramifications and family dynamics. Tracy's unique skills and experience have enabled her to become a trusted advisor to the family entrepreneur as well as to the second and third generations as they take on the transfer and management of family wealth. Tracy has lectured on a variety of estate planning and charitable planning topics. Tracy was recently named a 2015 Leader of the Bar by New Jersey Law Journal, has been named as a Super Lawyer Rising Star since 2009 and has served as a member of the Advisory Board of Peapack-Gladstone Bank since 2014. Also, in 2012 she received a Master of Laws (LLM) in Taxation. Prior to entering the legal field, Tracy was a senior tax associate at Deliotte & Touche LLP and Arthur Andersen LLP. She lives in Monmouth County with her husband and two daughters, Maeve and Sadie.

of intentions. But you should be vigilant in your continued scrutiny of the organization's activities, and you should always be prepared to expend your best efforts to help it attain its proper charitable objectives.

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