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ESTATE PLANNING

MINIMIZE TAXES WITH ESTATE PLANNING AND GIFTING

A comprehensive estate plan that includes gifting can help ensure your wealth is transferred according to your wishes and help you manage your estate's tax bill. Estate tax and gifting rules are complicated, and this overview covers only a few of the many issues to consider. Make sure to consult your financial advisor, tax advisor or attorney for assistance with designing an estate plan that fits your specific needs.

Reduce estate taxes by giving annually

Under current 2016 tax law, individuals can leave their heirs up to $5.45 million without federal estate tax liability.[1] Taxable estate greater than $5.45 million may be subject to estate tax at graduated rates up to a maximum of 40%.[1] Gifting not only allows you to share your wealth with your loved ones during your lifetime, it also decreases the value of your estate, which may reduce any estate tax your estate may have to pay after your death.

In 2016 each taxpayer is allowed to give a maximum of $14,000 per recipient to as many people as he or she chooses without any gift tax ramifications. Married couples can give $28,000 to each individual. So, for example, if you have four children and three grandchildren, in 2016 you can give $14,000 to each for a total of $98,000, or together with your spouse you can give a total of $196,000. The amount of this annual gift tax exclusion is subject to change each calendar year. However, in any one year, you may give as many people as you choose gifts up to that year's annual exclusion without gift tax liability.

Know your lifetime total taxable gift limit

Gift taxes are based on all property transferred throughout your lifetime. In 2016 each person has a lifetime gift tax exemption of $5.45 million. Not only are gifts that fall under the annual exclusion exempt from gift tax in the year they are made, they also are not included when adding up the lifetime total of gifts given.

By the numbers

- **Two for one:** With thoughtful estate planning, you may be able to reduce your beneficiaries' tax bill and gain peace of mind.
- In 2016, the federal estate tax exemption is $5.45 million and the maximum tax rate is 40%.[1]

[1] Source: irs.gov.

Key points

- In 2016 taxpayers are able to gift $14,000 per individual annually tax free.
- No gift tax return filing is required on the annual gifting allowance.
- No gift tax has to be paid until your lifetime total taxable gifts exceed the applicable exemption amount.
- Gifts to a spouse or a charity generally are not taxable.
- Married couples who want to leave heirs property that is valued above the deduction limits can consider estate equalization.

This material should be used as helpful hints only. Each person's situation is different. You should consult your investment professional or other relevant professional before making any decisions.

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Gifts above the annual exclusion limit are considered taxable gifts and require the filing of an IRS gift tax form. These amounts are also applied to the lifetime exemption. However, you will not actually pay any gift tax until your lifetime gifting total is greater than the $5.45 million limit (or the applicable limit in effect at the time). In addition, gifts to your spouse or to charity generally are not taxable.

College gifting options

If your goal is to pay for the future college expenses of your children or grandchildren, you may want to consider using your annual gift tax exclusion to establish a 529 college savings plan. You also can use the unique accelerated five-year gifting feature of a 529 plan to make a combined gift of up to $70,000 ($140,000 per married couple) to each beneficiary. This falls under the $14,000 a year tax-free limit as long as no additional gifts are made to that beneficiary for four years after the year you give the lump-sum gift.[2] However, in the event of your death before the end of the five-year period, a pro-rata portion of the gift will be added to your estate for estate tax purposes.

Here is another option: You can make payments directly to a qualified institution for tuition or to a health care provider for medical expenses — on behalf of someone else — without being subject to gift taxes. The gift tax exclusion for tuition and medical expenses is in addition to the annual exclusion per recipient.

Using the unlimited marital deduction

The IRS provides special tax considerations for spouses. Under what is called the unlimited marital deduction, any amount may be transferred to your spouse, during your lifetime or at death, without incurring either federal gift or estate tax, provided that both parties are US citizens. (If not, different rules apply.) Therefore, any estate taxes that might be due upon the death of the first spouse can be avoided by leaving all of the estate to the surviving spouse.

However, consider the following potential drawback to this approach: When the first spouse dies, his or her estate tax exemption ($5.45 million) goes unused because all of the property passes to the remaining spouse. If the surviving spouse dies still owning some of that property, it will then be included in his or her estate, but only one person's estate tax exemption amount would be used. The couple would pass the applicable exemption for one spouse to their heirs tax free, not the applicable exemption from two individuals. In order to take advantage of both spouses' estate tax exemptions, enough property must be owned by each individually.

Estate equalization and the marital deduction

Estate equalization is one approach that may make it possible for both husband and wife to benefit from their individual estate tax exemptions. It is typically used when one spouse's assets are considerably greater than the other's. The wealthier party transfers assets to his or her spouse so that both spouses have estates that are roughly equal in value. That way, it may be possible to apply the maximum estate tax exemption to each spouse's estate. Lowering the value of the wealthier spouse's estate may also reduce the estate tax rate that will apply.

Tax advantages of charitable gifts

Gifts to charities generally are not subject to gift taxes. Lifetime charitable donations also have two other advantages — they are eligible for income tax deductions and can reduce the size of the donor's estate.

Charitable bequests made upon death, via a will or a specially designed trust, may also generate estate tax savings. For example, Joe and Sheila Smith each have $5.45 million in separately owned property. They have no children and wish to leave as much money as possible to their favorite charities. When Joe dies, he could give all of this property to these charities and there would be no federal estate tax due upon his death. Sheila could continue to use her own assets for her support and then leave the remainder to charity, again avoiding any estate taxes. Alternatively, Joe could leave everything to Sheila and have no estate taxes because of the marital deduction. When Sheila dies, she would leave all of the remaining property to charity, and her estate would get the full deduction.

The value of trusts in estate planning

Irrevocable trusts can be valuable estate planning tools that may produce substantial estate tax savings. Trusts designed to hold life insurance policies can help keep the proceeds from the policies out of your estate. Other types of trusts can accomplish different objectives, such as facilitating charitable giving or effectively combining the use of the estate tax exemption and the unlimited marital deduction.

[2] Source: Finaid.org.

Complex federal and state laws can apply to the assessment of estate and gift taxes. In addition, some gifts and bequests can generate an income tax liability for the recipient. It is important to consult your estate planning professional, tax advisor or attorney to determine which gifting and estate planning strategies may work best for you.

Contact your financial advisor for more information or visit mfs.com.

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