How Taxes Could Affect Your Estate

The American Taxpayer Relief Act of 2012 resulted in “permanent” decisions on estate and gift tax laws. Tax law is really only permanent until Congress passes a new law; however, the provisions of this act are designed to be in place for some time. Consequently, it’s important to review your estate strategy with your legal and tax advisors to determine if any adjustments need to be made. The information highlighted in this report can help you get started.

Estate tax and exclusion amount – The federal estate tax exclusion amount for 2017 is $5.49 million for all individuals. This amount is adjusted for inflation annually, with the maximum estate tax rate being 40% for taxable estates. Therefore, you may be able to pass up to $5.49 million at death ($10.9 million for a married couple) free from federal estate tax.

Gift tax and exclusion amount – The gift tax exclusion amount is coupled with the state tax exclusion amount, so it is also $5.49 million. This means that you have the choice to save the full $5.49 million to give at your passing or any part of that can be used during your life, however if you gift during your life it will reduce the amount remaining at your passing. As such, you may be able to gift up to $5.49 million during your lifetime free from federal gift tax. Just like the estate tax exclusion, the maximum gift tax rate is 40% for taxable gifts. It’s important to remember, though, that any gifts made during your lifetime will reduce your estate tax exclusion amount dollar for dollar.

Portability provision for married couples – This provision states that when a person passes away, the surviving spouse may retain the deceased spouse’s unused exclusion amount. For instance, if a husband dies, his wife may be able to use their full $10.9 million exclusion without planning for it in advance. There are certain tax-filing requirements that must be satisfied to take advantage of this option. You should talk with your qualified tax advisor about your situation.

Generation-skipping transfer (GST) tax and exclusion amount – GST tax may apply when assets are transferred to “skip” people (generally someone more than one generation away from you, such as grandchildren and more remote descendants). The GST tax exclusion amount in 2017 is $5.49 million (which is adjusted for inflation annually). For any taxable transfer, the GST tax rate is 40%, which may be in addition to any other estate/gift tax liability that is due. Unlike estate/gift taxes, there is no “portability” (discussed above) of a spouse’s unused exclusion amount for GST tax purposes. As such, gifts that “skip” people who use the portable exclusion to limit or eliminate estate/gift taxes may still be subject to GST tax. You should discuss your situation with your estate-planning attorney or qualified tax advisor to determine whether GST tax may apply.
Strategies to Consider
You should consider time-tested strategies that can help meet your long-term legacy goals, manage possible gift and estate taxes, and remain flexible enough to react to future changes in the law.

1. Review your existing plan.
Consider the following scenario: with a $5.49 million personal estate tax exclusion, as a couple, Bob and Janet should review their existing estate plan to see if the size of the exclusion affects their legacy goals. After someone dies, trust documents may list creating a credit shelter trust as a first step. So if Bob dies, this could mean all of his assets in an estate worth less than $5.49 million could end up in a credit shelter trust, and Janet won't have complete discretion in using the trust assets. This may or may not be what Bob and Janet intended. Work with your attorney to confirm that your estate plan aligns with your legacy goals.

2. Compare portability to credit shelter trust planning.
You may think the portability provision means you don’t need to actively plan to protect your legacy and reduce estate tax. However, that may not necessarily be the case (see the chart below). Although portability, in some situations, may provide significant advantages to married couples over the long term, considering a credit shelter trust could have benefits for you and your family. By taking steps to address your estate now, you can help ensure your wishes will be carried out.

<table>
<thead>
<tr>
<th>Portability (Transfer to Spouse)</th>
<th>Credit Shelter Trust</th>
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<tr>
<td>Portability allows use of the deceased spouse’s unused exclusion amount.</td>
<td>Without portability, if the deceased spouse can’t use the full exclusion, the unused exemption could be lost.</td>
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<tr>
<td>The surviving spouse has full access and control over all of the assets.</td>
<td>The spouse who sets up the trust designates the beneficiaries of the trust. The surviving spouse and/or other beneficiaries may receive benefits from the assets in the trust during their lifetimes.</td>
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<tr>
<td>Growth of the assets may be subject to estate taxes when the surviving spouse dies.</td>
<td>Growth of the assets in the trust generally is not taxed for estate tax purposes upon the death of the surviving spouse.</td>
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<tr>
<td>Assets can be subject to creditor claims.</td>
<td>Assets are typically protected from creditor claims.</td>
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<tr>
<td>Assets may be subject to state estate taxes.</td>
<td>Assets may not be subject to state estate taxes.</td>
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<tr>
<td>All assets, including those from the first spouse to die, generally get a full step-up in basis at the surviving spouse’s death.</td>
<td>Assets do not get a step-up in basis at the surviving spouse’s death.</td>
</tr>
<tr>
<td>Portable exclusion does not apply to federal generation-skipping transfer (GST) taxes.</td>
<td>With proper planning, assets may not be subject to federal generation-skipping transfer (GST) taxes.</td>
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“Step-up” in cost basis remains at death
Cost basis generally is the price you paid for an asset. If you buy a stock for $5 per share, your “basis” is $5. If you still own that stock at death and the fair market value is $10, your estate may get a “step-up” in basis to the fair market value at death. So, your estate holds the stock with a $10 fair market value and a $10 basis, allowing your estate to pass assets to your beneficiaries at the new basis or to sell the asset potentially without capital gain. This typically means less income tax burden for your beneficiaries as they inherit your assets.

Important: Edward Jones, its employees and financial advisors do not provide estate-planning or tax advice, so it’s important to discuss the following with your estate-planning attorney and tax professional.
3. Consider taxable lifetime gifting.
For people who can afford to part with the assets, lifetime gifting can be an effective strategy to move assets, and the future appreciation and income stream, to beneficiaries. With the ability to shift $5.49 million, you can transfer significant assets during your lifetime. Instead of just a portion of a business or a family vacation home, all of the holdings may be able to be transferred. It’s important to note, though, that if you gift during your lifetime, you also give the beneficiary your cost basis for the asset, which could cause income tax consequences down the line. Also, the lifetime gift credit reduces, dollar for dollar, the estate tax exclusion.

4. Other estate reduction strategies remain.
Other estate reduction strategies can also help you meet your legacy goals. Items to consider when consulting with your tax and legal professionals may include the following:

- **Consider annual gifts during your lifetime.** You may gift up to $14,000 per person per year in 2017 ($28,000 if a married couple elects to “gift split”) to lower your overall estate, which reduces your potential estate taxes. This number will also increase with inflation over time.

- **Consider being charitable.** Giving to charities during your lifetime not only can help reduce your estate taxes but also may be an income tax deduction. If you choose to leave assets when you die to a qualified charity, you’ll receive a dollar-for-dollar deduction on your estate tax return for the value of those charitable gifts.

- **Discuss additional estate strategies.** Certain “transfer tax management” techniques will continue to be appropriate for high net worth clients. For example, an irrevocable life insurance trust (ILIT) is an irrevocable trust created to hold life insurance. With proper planning, the assets used to buy the policy and the death benefits of the policy may not be included as part of your estate because they are held in the ILIT. The policy’s proceeds can then provide available funds for your estate to help pay the estate tax. Several other techniques may be applicable for you. For each of these techniques, it’s important to work closely with your tax and legal advisors, who may offer other options to address estate tax concerns.

5. Periodically review your strategy.
Taking the time to review your plan can better ensure your strategy remains aligned with your goals, and the ever changing tax environment. Even if you completed a large lifetime gift that utilized the full exclusion amount, you may still be able to gift more without an estate tax liability. With increasing exclusion amounts you should review what federal exemption amount is available periodically.

Your tax and legal professionals and your Edward Jones financial advisor can work with you to determine what’s best for your situation. Further changes or extensions could be coming, so it’s important to review your situation periodically with your financial advisor to help ensure your legacy goals can be achieved.

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**Qualified Charitable Distributions**
A Qualified Charitable Distribution (QCD) allows you to give directly from your IRA to a charity that meets certain IRS guidelines. This donation may satisfy your RMD requirements.

- To make a QCD from a Traditional or Roth IRA, you must be age 70½ or older when the distribution is issued. This includes Inherited Traditional or Roth IRAs.

- The donation must be made directly from your IRA to a qualified charity. Donor Advised Funds and Charitable Giving Funds will not qualify for QCD treatment.

- The annual maximum distribution is $100,000 per person.

- The distribution must be taken on or before Dec. 31 of the current tax year.

*This report refers only to federal estate tax law. Many states have their own estate or inheritance tax. Work with your estate-planning attorney to determine whether you need to address state tax liabilities.

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