Estate Planning Strategies

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SFP SIGNATURE FINANCIAL PARTNERS, LLC

Daryl S. Brockman, AIF®
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With over 28 years of experience in the financial industry, Daryl continues to build a dedicated team of experienced and knowledgeable financial professionals prepared to assist clients in achieving their business, individual and family goals through diverse networks and personal relationships. Daryl's core practice areas are focused on:

- 401(k) Management
- Estate Preservation Strategies
- Executive Benefits
- Asset Management

In 1995, Daryl became the President and CEO of Signature Financial Partners, LLC and since then has grown the company to a top, award winning, nationally recognized firm, winning the coveted President's Trophy 7 times (top firm nationally out of 100 at Signator Investors).

Daryl works closely with *SEIA, LLC (seia.com);* a nationally recognized boutique asset management firm in Tyson's Va, in conjunction with the main office in Los Angeles, California. SEIA has recently surpassed over $6 Billion in assets under management and has consistently ranked in the **Top 15 RIA's nationally in Barron's** and other financial publications.

His credentials include holding the **Accredited Investment Fiduciary** (AIF®) designation in addition to multiple securities licenses, he's an active member of the John Hancock Hall of Fame and was recently recognized in **SmartCEO as a Top Money Manager in the Wash DC area**.

Due to his experience with 401(k)'s, Daryl has been an Adjunct Professor for The Plan Sponsor University (TPSU of UCLA) for the Wash DC region. He has also been an active participant with several industry and charitable organizations including: YPO International, President of Managing Partner's Association, Financial Planning Association (FPA), International Association of Financial Planning (IAFP), and the Alzheimer's Association: National Chapter, Charitable Board Member emeritus.

Daryl was born in Michigan and graduated from Miami University with a B.S. in Finance and an emphasis in Economics. Upon graduation Daryl relocated to the Great Falls, Virginia area where he has lived with his family for the past 25 years. Daryl and his wife, Christina, are proud parents of their son Alex, attending Wake Forest, and daughter Taylor who attends the Potomac School in McLean, Va. With a passion for sports, Daryl is frequently involved in Great Falls athletics and often coaches basketball and baseball in his free time. He is also a competitive golfer and member at the Trump National Golf Club of Washington DC and the Kinloch Golf Club.

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Financial Solutions *for Businesses*

SFP SIGNATURE FINANCIAL PARTNERS, LLC

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We meet with our clients through one-on-one financial counseling sessions, benefit fairs, enrollment meetings and phone calls. Not only do we answer pertinent questions regarding their retirement plan, but we encourage open dialogue regarding any financial issue weighing on their mind. With this open communication we may be able to provide added guidance as needed. This hi-touch service is part of the value we provide to all of our clients.

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John P. Dedon, Esq.
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Working in the estate planning, asset protection and business areas for more than 35 years, John helps clients preserve assets and plan for the future with traditional planning tools, including Trusts (dynasty trusts, intentionally defective trusts, grantor retained annuity trusts), LLC and partnership entities, and cutting- edge concepts such as cryonic preservation trusts. John also works extensively in the charitable area, creating public and private charities, remainder and lead trusts, supporting organizations, and churches. John's core practice areas are focused on:

- Estate Planning
- Asset Protection
- Tax Planning and Controversy
- Corporate and Business Planning
- Wealth Preservation

John was recently included as a **Washingtonian Best Lawyer and D.C. area's "Top Wealth Advisers"** in Washingtonian magazine. He was selected by his peers for inclusion in the **Best Lawyers of America** listing for 2018 for the sixth consecutive year. He has been listed among Virginia Business magazine's **"Legal Elite"** numerous times for Taxes, Estates and Trusts. John received an AV Rating, the highest rating given by Martindale-Hubbell® Peer Review Ratings for his legal ability and general ethical standards, in addition to being rated a **Martindale-Hubbell® Top Rated Estate and Trust Lawyer.**

John has been quoted extensively in newspapers throughout the country, including the **Wall Street Journal**, **Washington Post**, and **Chicago Tribune**. He has written numerous articles for professional journals and publications on tax issues and speaks on tax matters and wealth preservation issues for health care providers, certified public accountants, lawyers, financial planners, and the public. He is also the author of the blog, Dedon on Estate Planning, a regularly updated discussion of estate planning topics affecting Virginia residents and U.S. citizens. To read John's blog visit dedononestateplanning.com.

John's publications include:

- Cautionary Guidance for Operating a Private Foundation, Estate Planning magazine (2016)Tax Planning and Controversy
- Integrating Income Taxes in Modern Estate Planning Decisions—A Case Study, Tax Management Estate, Gifts and Trusts Journal (2016)
- Attorney Advises Medical Professionals on Estate Planning (2016)

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Key Estate Planning Considerations

Although Congressional action in the last few years has effectively eliminated federal estate and gift taxes for all but the wealthiest Americans, there is still a vital need to do estate planning.

Why? There are several key reasons: (1) to be sure that all of your wishes are followed after death; (2) to plan for *state* inheritance or estate taxes, if you live (or own property) in a state which levies such a tax; and (3) to plan in advance how to pay for any estate settlement costs. Federal estate tax law may have changed, but estate planning *still* matters.

Transfer of Assets

A primary objective is to insure that your assets go to those you want to receive them.

Method	Description
Will	Considered a key element in any estate plan, a will is a legal document, prepared under state law, which names those who should receive your property. An "executor" is generally named in the will to carry out your wishes. After death, "probate" will be required, a process in which the property listed in the will is distributed to the named heirs under court supervision. Unfortunately, the probate process is frequently expensive and time-consuming, and generally makes the contents of a will a public record. If you die without a will (termed "intestate"), your property will be distributed according to state law, which may result in your assets being distributed in a manner *not* in accordance with your wishes.
Revocable Trust	Also known as a "living" trust, a revocable trust can be changed or revoked during the lifetime of the trust creator (the "grantor," "settlor," or "trustor"). Such a trust is often used as a will substitute, when the grantor transfers assets into the trust during life or at death through a "pour-over" will. A revocable trust can make settling a decedent's estate easier and less expensive than probating a will and can also provide privacy not available in probate.
Irrevocable Trust	An irrevocable trust – as the name implies – cannot be changed once it is set up. These trusts are often used in estate planning for wealthy individuals. An irrevocable trust which holds life insurance can provide the funds needed to pay death taxes and other estate settlement expenses, while keeping the life insurance proceeds outside of the taxable estate.

Key Estate Planning Considerations

Method	Description
Joint Tenancy	Assets held in joint tenancy pass automatically at the time of death to the surviving joint owner, if living. In community property states, community property with right of survivorship has the same result. How ownership of an asset is "titled" can be important.
Beneficiary Designations	Some assets, such as life insurance policies, qualified retirement plans, and IRAs allow the owner to name a "beneficiary." At death, the policy death benefit or title to the asset automatically passes to the named beneficiary or beneficiaries. In some states, "Transfer-on-Death," (TOD) and "Pay-on-Death" (POD) allow certain types of property to automatically pass to named beneficiaries upon the death of the owner. Proper beneficiary designations are essential to make sure the assets pass according to your wishes.

Planning for Estate Transfer Costs

If proper prior planning is not done, estate and inheritance taxes, legal fees, and other estate settlement expenses can significantly reduce the legacy passing to your intended heirs.

Planning for estate settlement costs: Making maximum use of non-probate transfer methods such as revocable trusts, joint tenancy, community property with right of survivorship, or named beneficiaries, can help limit estate settlement costs and avoid the delay of probate.

Planning for estate taxes:[1] If the dollar value of an estate is large enough to be subject to estate and/or inheritance taxes, these taxes can add appreciably to transfer costs. In 2018, an estate with a net value of $11,180,000[2] or less is exempt from federal estate tax. This federal estate tax threshold is also known as the "applicable exclusion amount." However, most states with an estate or inheritance tax have estate tax thresholds which are considerably lower. Thus, an estate which has no federal estate tax liability could easily be subject to state death taxes.

Under federal estate tax law there are a number of ways to shrink the taxable estate:

- **Lifetime gifts:** each individual has an annual gift tax exclusion, currently $15,000[2] per person per year, generally allowing for tax-free gifts to others.

[1] The discussion here primarily concerns federal law; state or local law may differ.
[2] 2018 value. This amount is subject to adjustment for inflation in future years.

- **Marital deduction:** spouses who are both U.S. citizens can gift any amount to each other, generally with no estate or gift tax consequences. The survivor's now larger estate could face a greater estate tax problem when he or she later dies.

- **Charitable giving:** gifts to charities, during life or at death, reduce the estate size.

- **Bypass trust:** A type of trust known as a "bypass" trust allows the first-to-die of a married couple to set aside a portion of his or her assets. In years before 2011, such trusts were used in an effort not to "waste" the first-to-die's applicable exclusion amount. With the applicable exclusion amount currently set at a very high level, plus the introduction in 2011 of the "Deceased Spousal Unused Exclusion" (see below), for *federal estate tax* purposes at least, the bypass trust is less useful than before. When planning for *state death taxes*, however, often with much lower taxability thresholds, the bypass trust remains a useful estate planning tool.[1]

- **Deceased spouse unused exclusion (DSUE):** Beginning in 2011, a change in federal estate tax law provided that any portion of the applicable exclusion amount that remained unused at the death of a spouse could be held over and made available for use by the surviving spouse, in addition to the surviving spouse's own applicable exclusion amount. This "portability" opened up new planning opportunities that did not exist under prior law.

Paying estate settlement costs: While careful planning can help reduce estate settlement expenses, the planning process also needs to consider how to pay for the costs that do remain. There may be a need for funds to sustain the family until the estate is settled, to pay off debt or otherwise provide for the surviving spouse or children. An estate will often need to sell assets to raise the needed cash. While some assets are relatively liquid, others may take months or even years to be sold. Working with your investment advisor, you may need to rearrange some of your assets to provide increased liquidity to your estate. If there are currently not enough liquid assets in the estate, consider life insurance as a way to provide the needed funds.

Caring for Survivors

Your survivors – a spouse, minor children, or a disabled child of any age – must also be considered in the estate plan.

[1] There may also be other, *non-tax* reasons, for including a bypass trust in an estate plan.

A guardian for dependents: In case both parents are deceased, a guardian (and one or more alternates) should be named to care for minor children or other dependents.

Asset management: Professional asset management may be necessary to insure that financial resources are not squandered.

Who Makes Medical Decisions When I Cannot?

Modern medicine can now keep someone "alive" in situations that formerly would have resulted in death. Those who do not wish to have their lives artificially prolonged by such techniques must plan ahead and put their wishes in writing:

"Living Will": Also known as a "Directive to Physicians", this document provides guidance as to the type of medical treatment to be provided or withheld and the general circumstances under which the directive applies.

Durable power of attorney for health care: Many states have laws allowing a person to appoint someone to make health care decisions for them if they become unable to do so for themselves.

Durable power of attorney for financial affairs: Allows another individual to act on your behalf with regard to financial matters in the event of incapacity.

Outside the Legal Framework

Most of the documents involved in an estate plan are legal in nature and should be prepared by an attorney. However, not all documents involved in an estate plan are legal ones:

Letter of Instructions: A "Letter of Instructions" is an informal document that can include information such as your wishes regarding disposition of your remains, contact information for key advisors and family members, the location of important documents, the description and location of assets, user names and passwords for online accounts, or notes on family history. It is used to provide, in a private manner, direction and guidance to your family or executor in settling your estate.

Ethical Will: While a legal will or a trust is used to distribute assets, an "Ethical Will" serves to transfer values and beliefs. It is a very personal expression of the writer's life and values as well as the people, events, and experiences that influenced that life. In a very real sense, an ethical will is a spiritual legacy to future generations.

Seek Professional Guidance

Although an estate plan can be as simple as a set of hand-written instructions, there are a number of situations where legal guidance is considered vital:

To create a will or trust: An experienced attorney, familiar with local law, can prepare the legal documents required to meet the needs of your individual situation.

Estate taxes: If your estate is large enough to be subject to estate tax, your attorney can suggest ways to lighten the tax burden.

Squabbling heirs: Planning may be needed to minimize potential conflicts between your heirs or beneficiaries. Such disputes can occur when siblings don't get along or there are children from more than one marriage.

Property elsewhere: If you own property in more than one state or country, there may be a need for an ancillary probate. Living trusts are often used to transfer these assets and avoid the additional probate.

In addition to your attorney, your estate planning "team" will likely include experts from other disciplines such as income tax, life insurance, trust administration, charitable giving, and investment management. The professional guidance provided by such advisors is a key part of creating and implementing a successful estate plan.

Periodic Review

Because tax law and personal lives are never static, don't just put your estate plan in a drawer and forget about it. Many financial professionals recommend a periodic estate plan review.

Various Estate Planning Arrangements

A Summary of Benefits

Benefits	No Will	Basic Will	Trust Will	Basic Living Trust	Bypass with Living Trust	Bypass, QTIP,[1] & Living Trust
1. Allows you to select:						
a. Beneficiaries of estate,	No	Yes	Yes	Yes	Yes	Yes
b. Executor of will,	No	Yes	Yes	Yes[2]	Yes[2]	Yes[2]
c. Guardians for children, and	No	Yes	Yes	Yes[2]	Yes[2]	Yes[2]
d. Trustees of trust.	No	No	Yes	Yes	Yes	Yes
2. Avoids probate costs.[3]	No	No	No	Yes	Yes	Yes
3. Provides asset management for children over age 18.	No	No	Yes	Yes	Yes	Yes
4. Protects estate owner from a conservatorship.	No	No	No	Yes	Yes	Yes
5. Designed to save death taxes for couples.	No	No	Maybe[4]	No	Yes	Yes
6. Allows the first spouse to die to determine the ultimate beneficiaries of the estate in excess of $11,180,000[5], while still deferring the death taxes.	No	No	Yes	No	No	Yes

[1] QTIP stands for qualified terminable interest property trust.

[2] Each living trust is generally accompanied by a "pour over" type of will which picks up assets not put into the trust during lifetime and transfers them after death. Executors/guardians are named in a will.

[3] If all of the assets are in the living trust, probate is not necessary. However, there will usually be some expense for legal advice or the transfer of assets not in the trust. Without a trust, probate costs may exceed 5% of the total estate.

[4] Some trust wills contain bypass trusts designed to save death taxes, while others merely manage assets.

[5] The applicable exclusion amount is the dollar value of assets protected from federal estate tax by an individual's applicable credit amount. For 2018, the applicable exclusion amount is $11,180,000. In 2017, the applicable exclusion amount was $5,490,000.

Various Estate Planning Arrangements

Brief Description of Arrangement

- **No will:** Your estate passes to heirs picked by the legislature.
- **Basic will:** Generally passes everything to your spouse, if living, otherwise to your children when they reach age 18.
- **Trust will:** May contain bypass and QTIP trusts or may pass everything to your spouse, if living, otherwise for children.
- **Basic living trust:** Designed to avoid probate and provide asset management. Used for smaller estates and single persons.
- **Bypass with living trust:** Designed to set aside assets for specific heirs while giving the surviving spouse income and flexibility. Appreciation on assets inside the trust can avoid estate tax.
- **Bypass and QTIP with living trust:** Same as the bypass with living trust, plus it gives the first spouse to die more control over who will eventually receive his or her assets after the surviving spouse dies. Also called a QTIP trust.

The Federal Estate Tax

An Overview for 2018

The federal estate tax is an excise tax on the right to transfer property after death. The gross estate includes the fair market value of all assets owned by the decedent as of the date of death, including retirement plans and life insurance policies. When the taxable portion of an estate reaches $1,000,000, it enters the top estate tax bracket of 40%.

The tax applies only to taxable estates in 2018 that *exceed* the applicable exclusion amount of $11,180,000.[1]

Transfers between spouses generally qualify for the unlimited marital deduction and are free of current tax.

The estate tax return (Form 706) and any taxes due are generally payable nine months after date of death. In some situations, a portion of the taxes may be paid to the IRS in installments.

If the value of the estate assets declines during the first six months after death (which often happens if the decedent owned a business), the value (for all assets) as of six months after death may be used on the tax return.

Lifetime gifts that exceed the annual gift tax exclusion (In 2018, $15,000 per donee per year) will also reduce the estate owner's applicable credit amount.

Some transfers made during one's lifetime may be brought back into the decedent's estate. A few examples are listed below:

- Gifts of life insurance policies within three years prior to death.
- Transfer of an asset from which the donor retains an income for his or her life.
- Transfer of an asset where donor retains the right to alter or terminate the transfer.
- Assets placed in joint tenancy with another are included in the gross estate.

[1] The applicable exclusion amount is the dollar value of assets protected from federal estate tax by an individual's applicable credit amount. For 2018, the applicable exclusion amount is $11,180,000. In 2017, the applicable exclusion amount was $5,490,000.

How the Federal Estate Tax Works

A Simplified Illustration

1. DETERMINE THE GROSS ESTATE.

Total the fair market value of all assets the decedent owned:

- Residence, real estate.
- Business interests, stocks, bonds, retirement accounts.
- Life insurance, personal property, etc.

2. SUBTRACT THE DEDUCTIONS.

Certain items may be deducted to determine the taxable estate amount:

- Assets passing to surviving spouse.
- Debts of the decedent.
- Probate and burial expenses.
- Bequests to charities, etc.
- State death taxes.

3. CALCULATE THE TAX.

Using the taxable estate amount, calculate the federal estate tax.

Graduated tax rates are used, with the highest marginal rate in 2018 being 40%.

4. TAKE APPLICABLE CREDITS.

For assets passing to someone other than a spouse, reduce the tax by the applicable credit amount.

Other credits may apply.

5. PAY THE TAX.

After subtracting the credits, any remaining tax is due nine months after death – in cash.

Due in Cash

Presented by Daryl Brockman

Federal Estate Tax Worksheet

Assumes Death Occurs During 2018

A. Fair market value of real estate and business property $______

B. Fair market value of investments, stocks, bonds, funds, etc. ______

C. Fair market value of personal and other property ______

D. **Gross estate** (sum of items A, B and C) ______

E. Administration expenses (funeral expenses, etc.) ______

F. Debts of decedent ______

G. Marital deduction (assets to spouse) ______

H. Charitable deduction (bequests to charity) ______

I. State death taxes ______

J. **Total deductions** (sum of items E through I) (______)

K. **Taxable estate** (item D minus item J) ______

L. Adjusted taxable gifts (gifts made during life) ______

M. Estate tax base amount (sum of items K and L) ______

N. **Gross estate tax** (on item M from table below) ______

O. Applicable credit (maximum of $4,417,800)[1] ______

P. Gift taxes paid on lifetime gifts ______

Q. **Total credits** (sum of items O and P) (______)

R. **Net federal estate tax** (item N minus item Q) ______

[1] In 2018, the applicable credit may exceed $4,417,800 (up to a maximum of $8,835,600) if there is a "deceased spousal unused exclusion amount" available.

Valuation of Estate Assets

Assets belonging to the deceased estate owner are included in his or her estate at their fair market value on the date of death or, if the executor elects, their value six months after date of death.[1]

A Few Selected Assets

Type of Assets	How Asset Is Valued	Reference
Listed stocks and bonds (including over the counter)	The mean between highest and lowest quoted selling prices on the valuation date.	Reg. Sec. 20.2031-2(b)(1)
Mutual funds	Valued at their bid price or redemption value (i.e., the amount the fund would pay the shareholder if it redeemed the shares on the valuation date).	Regs. Secs. 20.2031-8 (b) and 25. 2512-6(b); U.S. vs. Cartwright, 411 U.S. 546 (1973)
Survivor's annuity (under a joint and survivor annuity contract)	The amount that the same insurance company would require for a single life annuity on the survivor, as of the applicable valuation date.	Reg. Sec. 20.2031-8
Close corporation stock	Fair market value is based on history and nature of business, economic outlook, book value, earning capacity, dividend paying capacity, goodwill, recent sales of stock and similar publicly traded company stock.	Rev. Rul. 59-60, 1959-1 CB 237
Real estate	Fair market value of real estate in the United States or in a foreign country.	IRC Secs. 2031, 2032A, 2033
Real estate (farm or corporate owned)	Value may be determined by actual use rather than on its highest and best use if certain conditions are met.	IRC Sec. 2032A
Mortgages and notes	The amount of the unpaid principal plus accrued interest, unless a lower value can be proven (i.e., an insolvent debtor).	Reg. Sec. 20.2031-4

[1] "Six months after date of death" is referred to as the "alternate valuation date." Use of the alternate valuation date election must reduce both the value of the gross estate and the federal estate tax liability. If this election is made, assets sold or distributed during the six-month period are valued at the date of sale or distribution. Under proposed regulations, generally effective for decedents dying on or after April 25, 2008, the alternate valuation date method may be elected only if the property remaining in the estate six months after the decedent's death has declined in value due to "market conditions" and not merely because of a lapse of time or other post-death event.

Valuation of Estate Assets

Type of Assets	How Asset Is Valued	Reference
Life insurance on the decedent's life	Amount receivable by the estate or by a named beneficiary, if the deceased insured had incidents of ownership in the policy.	Reg. Sec. 20.2042-1
Life insurance policy owned by decedent on the life of another person	The cost of buying another policy of the same value and same type on the same insured.	Reg. Sec. 20.2031-8
Joint tenancy with a spouse	One-half of the value of property owned jointly by spouses is included in the estate of the first spouse to die.	IRC Sec. 2040(b)
Joint tenancy with other than spouse (general rule)	Entire value of property less the original contribution of the survivor is included in the estate of the first joint tenant to die.	IRC Sec. 2040(a)

How Are Death Taxes Paid?

Death taxes are due and payable in cash within nine months after the taxpayer's death.

Five Ways to Provide Money for Death Taxes

- **The executor may borrow the cash:** This only defers the problem, since the money will have to be repaid with interest. This includes installment payments to the government.
- **The taxpayer may pay in cash:** Rarely does a person accumulate large sums of cash. If he or she does, he or she probably will forego many profitable investment opportunities in order to keep the estate in a liquid position.
- **The taxpayer may sell stock market investments:** This may be a wise choice if the market is "up" when the stocks or bonds need to be converted to cash and the taxpayer has been investing long enough to accumulate the necessary amount.
- **The executor may liquidate other assets:** If there is not a ready market, however, the assets may be sold at a great loss.
- **The taxpayer can pay his or her estate settlement costs with life insurance.**

Advantages of Life Insurance

- The insured's beneficiaries almost always get back more than he or she paid in.
- Payment of benefit is prompt.
- There is generally no income tax on the proceeds.
- Proceeds may be free of estate tax.
- Payments can be spread out rather than paid all at once.
- It avoids many of the problems of the other four methods set forth above.
- The proceeds are generally not subject to probate.
- Life insurance provides cash for a predictable and certain need which will arise at some unpredictable moment.

Death Tax Reduction

The federal estate tax, which is imposed on taxable estates exceeding $11,180,000,[1] can be reduced through various techniques:

- **Lifetime gifts:** Each person can make annual gifts of $15,000[2] ($30,000 per couple, if married) to any number of donees, e.g., children or grandchildren, without incurring Federal gift tax.

- **Charitable transfers:** Bequests at death or lifetime charitable gifts can reduce the estate size and thus reduce the death tax. Charitable gifts made during life provide the added benefit of an income tax deduction. Gifts can be of a partial interest; for example, one can retain the right to income for life. Such "split-interest" gifts must be made in a trust, either a charitable lead trust or a charitable remainder trust.

- **Marital transfers:** Generally, neither lifetime gifts nor bequests at death to one's spouse are subject to death taxes. This in effect defers the tax until the surviving spouse dies. Special rules apply to non-U.S. citizen spouses.

- **Bypass trust:** This type of trust allows the first-to-die of a married couple to set aside up to $11,180,000[1] for specific heirs, while providing income and flexibility to the surviving spouse. Appreciation on assets inside the trust can avoid estate tax.

- **Deceased spouse unused applicable exclusion amount:** Any applicable exclusion amount that remains unused at the death of the first spouse to die is generally available for use by the surviving spouse, as an addition to his or her own applicable exclusion amount.

- **Estate value freezing techniques:** Corporate recapitalizations, personal holding companies and multi-tier family partnerships which previously transferred future growth of a business to a younger generation while still retaining power to control the business, have been almost eliminated.

[1] The applicable exclusion amount is the dollar value of assets protected from federal estate tax by an individual's applicable credit amount. For 2018, the applicable exclusion amount is $11,180,000. In 2017, the applicable exclusion amount was $5,490,000.

[2] 2018 value. This amount is subject to adjustment for inflation in future years.

- **Private annuity:** Generally, a private annuity is the sale of an asset to a younger generation in exchange for an unsecured promise to pay annual amounts for the seller's lifetime. This removes the assets from the estate; however, the payments, if accumulated, could build up over the seller's life expectancy to the size of the asset which was transferred.[1]

- **Life insurance trusts:** By transferring small amounts of the estate (equal to the insurance premium) to an irrevocable life insurance trust, an estate owner can reduce his or her current estate while creating a much larger asset outside the estate. The proceeds of the policy will not be subject to income taxes or federal estate taxes at the estate owner's demise. See IRC Sec. 101(a).

[1] On October 17, 2006, the IRS issued proposed regulations (NPRM REG-141901-5) on the exchange of appreciated property for an annuity contract. These proposed regulations treat the transaction as if the transferor had sold the property for cash and then used the proceeds to purchase an annuity contract. The proposed regulations are generally effective for transactions occurring after October 18, 2006.

Bypass and QTIP Trusts

Under federal law, each individual has an "applicable exclusion amount," a specified dollar amount of asset protected from federal estate tax. Between spouses, however, a person can pass any size estate to his or her U.S. citizen spouse[1] without concern for a federal estate tax because of the "unlimited marital deduction." For many married couples, an "I love you" will simply leaves everything to the surviving spouse.

Before 2011, however, when the surviving spouse later died, and the combined estate passed to the ultimate heirs, there was only the survivor's single applicable exclusion amount to shield the estate from federal estate tax. Using the unlimited marital deduction at the first death, in effect, <u>wasted</u> the applicable exclusion amount of the first-to-die.

To preserve the applicable exclusion amount of the first-to-die, many married couples used a "bypass" trust (also called an "exemption" or "credit shelter" trust). At the first death, the bypass trust would be funded with assets up to the applicable exclusion amount in effect for that year. A bypass trust is not subject to federal estate tax at either the first or second death, even though the assets in the trust may appreciate greatly in value.

A bypass trust is also useful in that it can be written to give the surviving spouse access to the income from the trust for life, as well as access to the trust principal, in extreme situations, for his or her health, education, support, and maintenance.

Additional Planning

Sometimes a second trust, called a "QTIP" trust, is added to the bypass trust. QTIP is an acronym for "qualified terminable interest property" trust. The QTIP allows the first spouse to die to give lifetime benefits (such as income earned on trust assets) to his or her spouse, while still retaining the right to name the persons who will ultimately receive the trust assets. Use of a QTIP recognizes that human nature is less than perfect:

[1] If the surviving spouse is not a U.S. citizen, special rules apply.

- **Children of a prior marriage:** In an age when divorce is common, a QTIP trust is particularly useful in protecting children of a prior marriage from being cut off by a surviving step-parent spouse.
- **Close friends:** A QTIP also reduces the possibility of the estate passing to a subsequent marriage partner or "close friend" of the surviving spouse.

Careful drafting is required to make certain the QTIP trust qualifies for the unlimited marital deduction. Special language is required if the QTIP is the beneficiary of an IRA. See Rev. Rul. 89-99, 1989-2CB 231.

2010 and 2012 Tax Legislation

The 2010 Tax Relief Act brought a number of significant changes to federal estate tax law. One provision increased the applicable exclusion amount to $5,000,000 in 2011 and to $5,120,000 in 2012. Another section provided that any applicable exclusion amount remaining unused at the death of the first-to-die of a married couple could be carried over and used by the survivor, in addition to the surviving spouse's own applicable exclusion amount.

The American Taxpayer Relief Act of 2012 made permanent a number of the provisions in the 2010 Tax Relief Act, including the increased applicable exclusion amount and the carryover of any unused spousal applicable exclusion amount.

Tax Cuts and Jobs Act of 2017

The Tax Cuts and Jobs Act of 2017 (JCTA), for 2018 – 2025, increased the base applicable exclusion amount from the $5,000,000 level set in the 2010 act, to $10,000,000.[1] Adjusted for inflation, the applicable exclusion amount for 2018 is $11,180,000. Thus, for 2018, the combined effect of all these changes is to effectively protect from federal estate tax up to $22,360,000 in assets, with or without a bypass trust.

Is the Bypass Trust Dead?

With such a large dollar amount protected from federal estate tax, many estate owners will find that a bypass trust is no longer necessary, at least from a *federal* estate tax perspective.

[1] Under current law, in 2026, the $5,000,000 base applicable exclusion amount will again apply, adjusted for inflation.

When planning for *state* death taxes, however, which often have much lower taxability thresholds, the bypass trust may continue to be a valuable estate planning tool. Note that there may also be *non-tax* reasons for including a bypass trust in an estate plan.

Those with estates large enough to be subject to federal estate tax will likely benefit from continuing to use bypass trusts as a part of their estate plan.

Seek Professional Guidance

All estate owners are strongly advised to consult with appropriate financial, tax, and legal professionals as to the steps to take to best benefit from this changed estate planning environment.

Types of Trusts and Their Tax Treatment

Type of Trust	Income Tax	Estate Tax	Gift Tax
Testamentary trust: Created in the trustor's will and takes effect only at his death. Can be used to avoid tax on a portion of the first spouse's share of the estate, e.g., the bypass trust.	Income which is distributed is taxed to the beneficiary; if income is accumulated, it is taxed to the trust until later distributed to the beneficiary.	Trust assets are included in decedent's estate.	No gift tax.
Revocable living trust: Created while the trustor is still living but can be revoked or amended during his or her lifetime. Assets in the trust will avoid probate expenses, delay and publicity.	No income tax savings while trustor lives. After death, same as testamentary trust for income tax purposes.	Trust assets are included in decedent's gross estate.	No gift tax. Trust is revocable.
Irrevocable life insurance trust: Created while the trustor is still living and cannot be revoked by the trustor. Used to reduce the size of the estate. Works best for removing insurance from the estates of both spouses. Some are "funded," and others are "unfunded" or just own a life insurance policy.[1]	Same as testamentary trust above, except if income from a funded trust is accumulated, it is taxable to the trustor.	Usually excluded unless gift of policy was within three years prior to insured's death.	There may be a gift tax liability, but gifts to the trust can usually be made to qualify for the $15,000[2] annual gift tax exclusion.
Sec. 2503(c) minor's trust: A type of irrevocable trust for minors which qualifies for the annual gift tax exclusion even though the gifts to it are "future interest."[3]	Same as testamentary trust above.	Usually excluded unless transfer was within three years prior to death.	There may be a gift tax liability, but gifts to the trust can usually be made to qualify for the $15,000[2] annual gift tax exclusion.

Note: For 2018-2025, if a child subject to the "Kiddie Tax" has unearned income in excess of certain limits ($2,100 for 2018), the excess is taxed according to the brackets applicable to trusts and estates. The remainder of a child's taxable income is taxed at the child's rates. State or local law may vary.

[1] Cash contributions may be made to the trust, to be used by the trustee to make premium payments on the life insurance policy. Careful drafting of the trust document is required to qualify the cash gifts for the annual gift tax exclusion.

[2] The annual gift tax exclusion ($15,000 in 2018) is indexed for inflation in increments of $1,000.

[3] Under federal law, the minor must become the owner of the assets no later than age 21.

Irrevocable Life Insurance Trust for a Married Couple

Since estate taxes are imposed upon all of the assets in the estate, many people prefer to pay the taxes by rearranging some of these assets instead of relying on their current income.

One method of achieving this goal is the irrevocable life insurance trust (ILIT). To prevent inclusion in the estate, an irrevocable trust cannot be revoked or amended by the grantor.

- **Funded irrevocable insurance trusts:** This trust has income-producing assets transferred into it which will pay the premiums on the insurance policy from the income earned. Irrevocable life insurance trusts are typically not funded with a single, lump-sum payment because the gift taxes on the assets transferred are the same as the federal estate taxes on assets remaining in the estate. Also, if the trust is a “grantor trust” for income tax purposes, the income earned on the assets would still be included on the income tax return of the insured grantor. See IRC Sec. 677(a)(3).
- **Unfunded irrevocable insurance trusts:** Although this trust is not totally unfunded, it usually just owns an insurance policy and the grantor makes annual gifts to the trust with which the trustee can pay the premiums.

Additional Considerations

- **Trust is irrevocable:** This means that the grantor cannot get anything out once it is put into the trust. Some suggest that a special power of appointment in the hands of the insured’s child would permit that child to appoint the trust assets back out to the insured or others. In an uncertain estate planning environment, this flexibility may be very desirable. The trustee would need to be authorized to reappoint trust assets without liability to the trust beneficiaries.

- **Annual gift tax exclusion may be lost:** Contributions to the trust are generally “future” interests instead of “present” interests. Future interests typically do not qualify for the $14,000 (in 2017) annual gift tax exclusion. This concern can be overcome by granting to the beneficiaries a limited power to withdraw certain sums from the trust for a short time after the grantor makes the contribution. This is sometimes referred to as a Crummey provision after the case which decided the validity of this technique (Crummey vs. U.S., 397 F.2d 82 (CA-9, 1968)). The rules set forth in this case and subsequent rulings must be carefully followed. Crummey power holders should be actual trust beneficiaries; however, the tax court allowed annual gift tax exclusions for contingent beneficiaries (e.g., children, grandchildren, etc.) who were given withdrawal rights (Est. of Maria Cristofani vs. Comm., 97 T.C. 74 (1991)).1

- **Non-exercise of withdrawal powers:** The failure of a beneficiary to withdraw the amounts permitted under the Crummey provision will cause a lapse of that power. Lapsed amounts in excess of the specified limit[2] are generally considered to be taxable gifts from the beneficiary. However, if the beneficiary is given a limited power to appoint the amount in excess of these limits (e.g., in his or her will), the power is deemed not to lapse and therefore no gift tax is due.

  Another strategy used to deal with this problem is referred to as a "hanging" power. It limits the amount which lapses each year to the larger of $5,000 or 5% of trust assets. Any amount in excess of this limit "hangs" or carries over to later years. The IRS has, in one situation stated its opposition to this method. See TAM 8901004.

- **Three-year rule:** If an existing life policy is gifted by the insured to an irrevocable life insurance trust and the insured dies within three years of the transfer, the policy proceeds will be included in the insured's estate. IRC Sec. 2035. On the other hand, if the trustee uses cash in the trust to purchase a new policy on the insured's life and the insured dies within the three-year period, the proceeds will generally be excluded from his or her estate. Care should be taken to make certain that the insured has no incidents of ownership in the policy or control over the trustee.

- **Second-to-die policies:** Second-to-die or survivor life policies do not pay the proceeds until both spouses are deceased, which is when the death taxes generally become due. Premiums on a single second-to-die policy are generally lower than the combined premiums on two individual policies, allowing a couple to obtain a larger face amount of insurance. If the surviving spouse will need policy proceeds to live on, however, this type of policy should generally not be used.

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[1] The IRS has continued to attack the conclusion reached in the *Cristofani* case, using a substance-over-form argument. Individuals planning an irrevocable trust similar to that involved in *Cristofani* are advised to consult an attorney on the steps needed to avoid having the IRS conclude that gifts to an irrevocable trust are not gifts of a present interest.

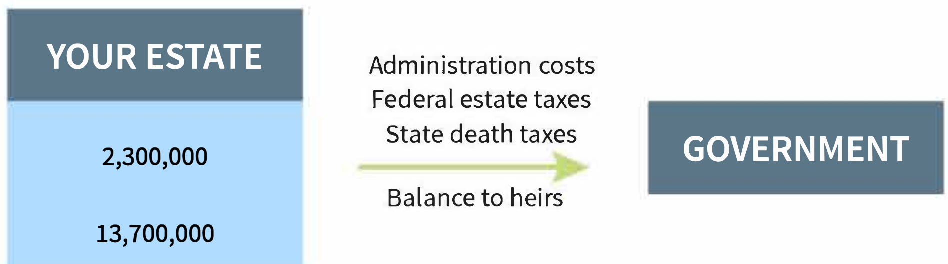
[2] The limit is the greater of $5,000 or 5% of the value of the assets subject to the power.

Paying Estate Costs with Estate-Tax-Free Dollars

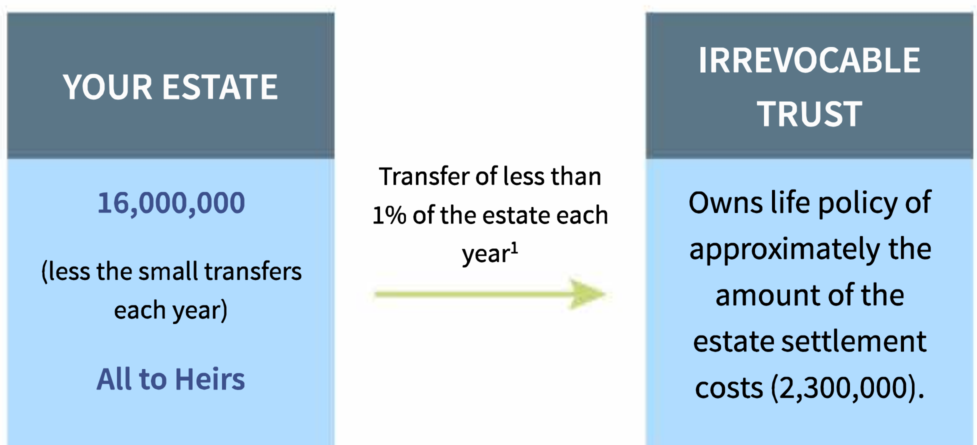
Since estate taxes are imposed upon the value of the assets in one's estate, many people prefer to pay for these taxes by repositioning these assets, rather than trying to solve the problem entirely from their current earnings.

The following method of systematically transferring small amounts of capital from the estate appeals to many estate owners.

Assume an estate of 16,000,000, with death occurring in 2018.



With a little planning, the entire estate may be kept intact.



At death, this 2,300,000 can be lent to the executor to pay for the estate settlement costs or it can be used to purchase assets from the estate. The income earned by the trust assets can go to the surviving spouse and the remainder can pass to the children after his or her demise, without being taxed in his or her estate.

[1] Assumes approximate cost of a permanent type life insurance policy on a 50-year-old male. Actual amount will vary.

Presented by Daryl Brockman

Family Limited Partnership

Family limited partnerships (FLP) can be used with business, personal or investment assets. Their traditional purpose has been to divide investment income with children in lower income tax brackets and increase the family's net spendable income.

They have also been used for long-range estate planning. Closely held businesses, along with other assets, are subject to Federal estate and generation skipping transfer taxes. These taxes can effectively prevent the transfer of a family business from one generation to the next. The FLP provides a valuable estate planning tool to lessen these tax burdens.

In recent years, such partnerships have also been employed as a method of protecting family assets from creditors.

IRC Sec. 704(e) effectively limits FLPs to business/investment activities where capital is a material income-producing factor, as contrasted with activities which earn income by providing services.

How It Works

The parents set up a FLP and transfer capital assets into the partnership. Within the partnership structure, the parents act as the general partners; the children (or grandchildren) are the limited partners.

In a limited partnership, the general partners often own only a small proportion of the partnership (for example 5%), while the limited partners own the majority interest. The general partners have complete responsibility and control of partnership activities, as well as the liability for partnership debts and losses.

The limited partners have no control or management rights. Their liability is limited to the amount of their contribution to the partnership.

One of the most attractive features of the FLP is its flexibility. Some estate planning strategies must be irrevocable in order to be effective. Once set up, these irrevocable tools cannot be changed or undone. By contrast, the FLP document can be modified to respond to changes in the family or business structure.

Reasons to Consider a Family Limited Partnership

There are three primary reasons for creating an FLP:

- **Income tax benefits:** Income generated by a limited partnership is often allocated according to ownership. With the limited partners (the children or grandchildren) owning the majority interest, most of the income generated could flow through to them and be taxed at their lower marginal tax rate.

- **Estate planning benefits:** When the parents contribute assets to the partnership, they are transferring asset value and shifting asset growth from themselves to a younger generation.

Consider the following hypothetical example in which a business has a current value of $200,000 and is expected to grow by 10% per year. Over time, the parents transfer 90% of the business to the children.

	Retain for Parents	Contribute to FLP
Current value	$200,000	$200,000
Amount transferred to children	$0	$180,000
Amount remaining in estate	$200,000	$20,000
Asset value in 20 years	$1,345,500	$134,550
Federal estate tax assumed at 40%	$538,200	$53,820
Potential estate tax savings	**$484,380**	

Often a gifted ownership interest can receive a discounted value because the interest is either a minority interest or lacks marketability. This minority interest issue should be carefully reviewed with your legal advisor:

- **Protecting assets from lawsuits:** Most state limited partnership statutes prevent the creditors of a limited partner from attaching partnership assets. While the creditors may get a charging order against the debtor's partnership interest, as a practical matter it is very difficult to collect the debt. The FLP may provide one of the most effective asset protection structures available today.

Family Limited Partnerships Are Not for Everyone

Before considering a FLP, there are a number of questions that the parent or parents must answer. Do they really want to have a child involved in their business? Will the income shared with the child affect the parents' lifestyle? Will a gift tax be due and payable when the transfer is made to the child? Will the income tax savings compensate for the increased complexity?

Additionally, legal counsel must be obtained. Because of the complexity involved, FLPs are not appropriate for every situation. The documentation for such a partnership must be carefully designed to avoid problems with both federal law and the law of the state under which the limited partnership is being created.

Dynasty Trust

A "dynasty trust" is a strategy used by the very wealthy to create a lasting financial legacy for children, grandchildren, and descendants as yet unborn. The name derives from the fact that a dynasty trust is structured to last as long as legally possible. A long "life" allows assets in the trust to grow for an extended period of years without being periodically depleted by transfer taxes, such as federal estate, gift, or generation-skipping transfer tax (GSTT)[1] as the assets pass from one generation to the next.

Because trust assets can be a tempting target, Dynasty trusts are also designed to provide protection from creditors in case of bankruptcy, a lawsuit, or divorce.

Parties to a Trust

- **Donor, grantor, or trustor:** The individual or individuals setting up the trust and contributing assets.
- **Trustee:** The individual or entity responsible for managing the trust.
- **Beneficiary:** The individual or individuals who receive the income and, ultimately, the trust assets.

Rule Against Perpetuities

At one time, all 50 states limited the legal lifespan of a trust. This "Rule Against Perpetuities" commonly limited a trust's lifespan to no more than 21 years after the death of the youngest beneficiary alive at the time a trust was created. Thus, 21 years after the death of the youngest beneficiary, the trust would terminate and trust assets would be distributed. More recently, a number of states have moved away from this rule, allowing for trusts that, theoretically at least, could run forever, or as long as there are beneficiaries alive.

General Trust Considerations

A dynasty trust involves the use of an "irrevocable" trust. Once the trust has been funded, the grantor may not change its terms or recover assets from the trust. Because the trust is irrevocable, and because a dynasty trust may last a long time, very careful planning is required. Factors to consider include:

[1] The discussion here concerns federal law. State or local law may differ.

- **When:** The trust may be set up during life or at death.
- **Trust location:** The trust should be created under the laws of a state which allows for a longer trust lifespan. It is not necessary for the grantor or the beneficiaries to live in that same state.
- **Trustee:** A corporate trustee, such as a bank or independent trust company, is often recommended.
- **Powers given to trustee and beneficiaries:** The grantor has wide flexibility in specifying the powers given to the trustee and to the beneficiaries. A grantor will want the beneficiaries to benefit from the accumulated wealth without having it included in their estates at death. "Spendthrift" provisions help provide protection against outside creditors. Since the future is unknown, trust provisions need to provide some flexibility to meet changing circumstances.
- **Income taxation:** Income distributed from the trust will be taxed to the beneficiary who receives it. If income is retained by the trust, it will be taxed to the trust itself at very high marginal tax rates. The donor could also choose to structure the trust as an "intentionally defective grantor trust" and be taxed on the income from the trust, even though he or she does not receive the income. This can allow the trust to be more valuable to future generations.
- **Trust assets:** Any type of property can be contributed to the trust, although appreciating assets are frequently chosen. Life insurance, on the life of the grantor or trust beneficiaries, can be used to leverage wealth transfer. The grantor may also contribute ownership interests in entities such as a family limited partnership or limited liability company, where valuation discounts for lack of marketability or control may apply.

Transfer Taxes

A donor may transfer assets to a dynasty trust either during life or at death. If the transfer is made during life, there may be a federal gift tax to pay. If the transfer is made at death, the transfer is subject to the federal estate tax. If trust assets or income pass to a beneficiary in a generation two or more below that of the grantor, the Generation-Skipping Transfer Tax (GSTT) also applies. The dynasty trust may be exempt from the GSTT to the extent the donor allocates his or her available GSTT exemption to the trust.

To offset these transfer taxes, each individual is allowed a certain dollar amount of assets which can be transferred to others without paying any transfer tax. In 2018, this dollar amount is equal to $11,180,000 for gift, estate, and GSTT taxes. Thus a single donor can transfer up to $11,180,000 during life or at death, to any beneficiaries, without paying any transfer tax. If both spouses of a married couple agree to combine gifts, in 2018 up to $22,360,000 may be transferred into a dynasty trust without paying any transfer taxes.

Once inside the trust, and assuming that the beneficiaries do not have powers which would cause trust assets to be included in their estates at death (and thus create a potentially taxable transfer), the assets can continue to grow without the burden of additional transfer taxes.

"Selling" Assets to the Trust

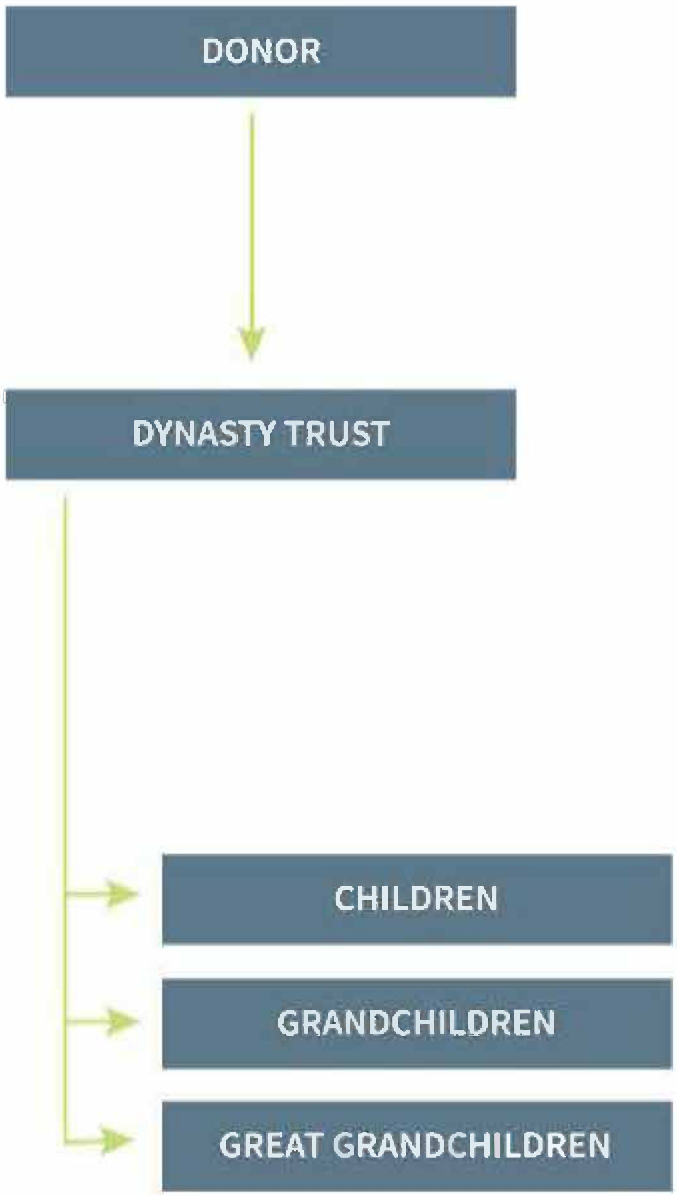
A donor may also choose to "sell" assets to a dynasty trust, typically in exchange for an installment note of equal value. Because the transfer is a sale, no transfer taxes apply to the transaction.

Seek Professional Guidance

Use of a dynasty trust is an estate planning technique that generally is limited to very wealthy individuals and families. Once such a trust is funded, it is irrevocable. Because of the complexity of the law surrounding such trusts, and the fact that such laws can change, the guidance of knowledgeable, experienced tax and legal professionals is highly recommended.

How a Dynasty Trust Works

A dynasty trust is used to create a financial legacy extending many years into the future.



- Establishes irrevocable trust during life or at death.
- Transfers assets into the trust. Pays gift tax if transfer is during life or estate tax if transfer is after death[1].
- Specifies powers given to trustee and beneficiaries[2].

- Trustee manages trust assets for the benefit of the beneficiaries.
- “Spendthrift” provisions can help provide protection from outside creditors.
- Trust pays income tax on retained income.

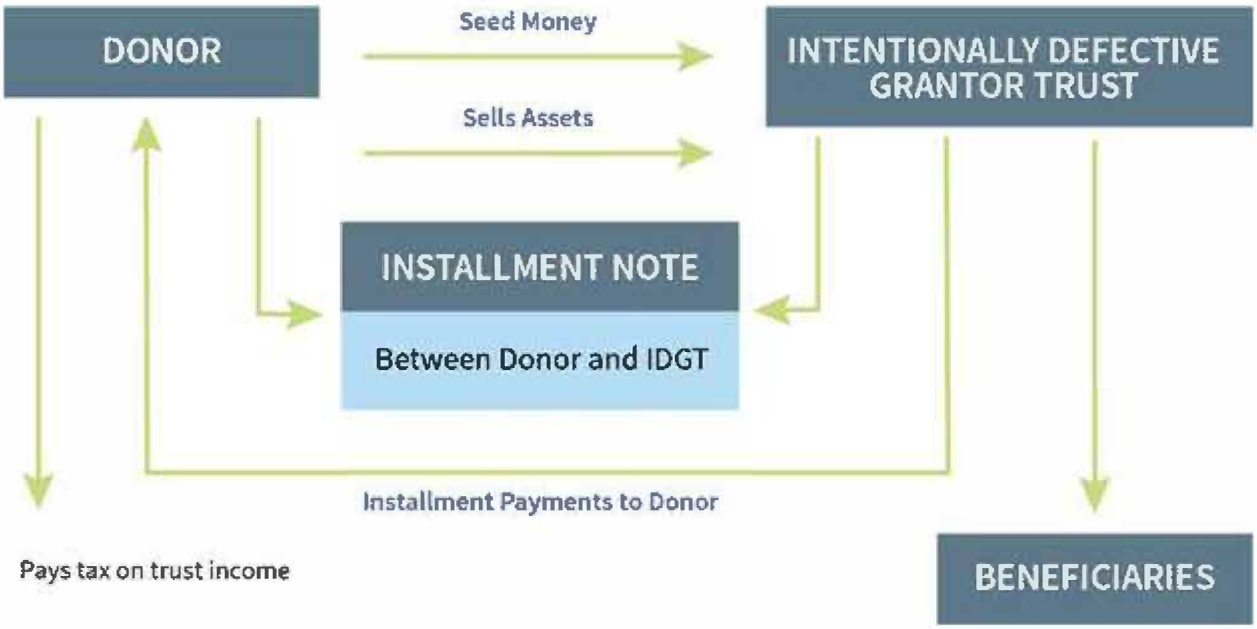
- Trustee distributes income and assets to beneficiaries as specified by donor.
- Beneficiaries pay income tax when income received.

[1] The discussion here concerns federal income, estate, and gift taxes. State or local law may vary widely. If assets or income pass to a beneficiary two or more generations below that of the grantor, the Generation-Skipping Transfer Tax (GSTT) also applies.

[2] Because of the complex nature of dynasty trusts, and the fact that, once established, they are irrevocable, the guidance of knowledgeable, experienced tax and legal professionals is strongly recommended.

How an Intentionally Defective Grantor Trust Works

An Intentionally Defective Grantor Trust (IDGT) is an estate planning strategy used to transfer appreciating assets to others with the least possible income tax, gift tax and estate tax burden.[1]



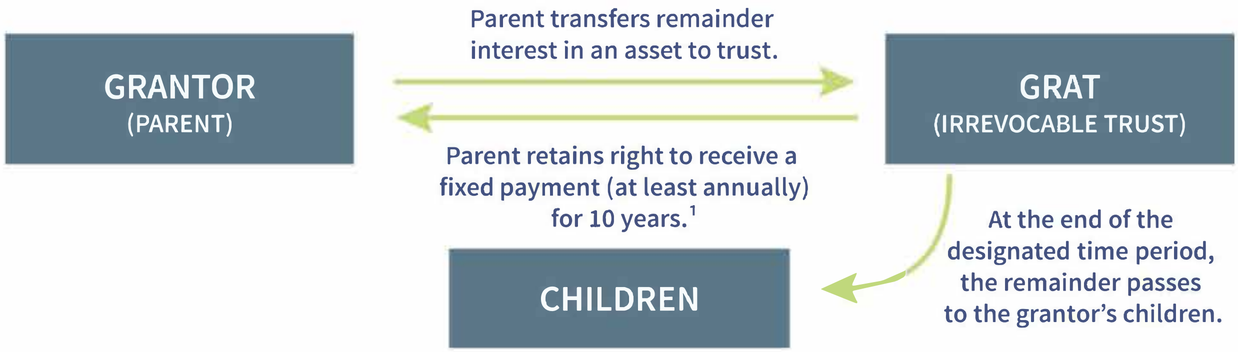
- Donor establishes IDGT and transfers "seed money" to trust. This transfer may be subject to gift tax.
- Donor then sells assets to trust in a bona-fide sale.
- Donor receives installment note from trust in exchange for the assets sold to the trust.
- IDGT makes installment payments to donor.
- Because the trust is "defective," donor pays income tax on trust income.
- At donor's death, assets in trust pass to beneficiaries.[2]

[1] The discussion here concerns federal income tax, gift tax, and estate tax law. State or local law may vary widely.
[2] Because of the complexity of an IDGT, the guidance of knowledgeable tax and legal professionals is highly recommended.

Presented by Daryl Brockman

How a Grantor-Retained Annuity Trust Works

An estate owner may use the GRAT to transfer assets and future appreciation to children.



The value of the transferred asset minus the value of the retained annuity interest will equal the value of the remainder interest that is subject to gift taxation.

Assumptions:

Value of asset placed in GRAT: $500,000
Age of grantor: 65
Type of payment: End of year
Term of payment: 10 years
Federal discount rate (changes monthly): 2.0%

Annual Payment to the Grantor	First-Year Payment as a Percentage of the Asset[2]	Value of the Retained Interest	Gift Tax Value of the Remainder Interest
$30,000	6	$269,478	$230,522
40,000	8	359,303	140,697
50,000	10	449,129	50,871
60,000	12	500,000	0

The cost of the transfer would be the gift tax on the value of the remainder interest. The gift is of a future interest and does not qualify for the annual gift tax exclusion. The gift tax on assets up to $11,180,000[3] is first offset by an individual's applicable credit amount. The tax on gifts that exceed $11,180,000 must be paid in cash in the year the gift is made.

[1] The payment period can be for the life of the grantor, for two or more joint lives or for a set number of years.
[2] In subsequent years the dollar amount of annual payment would remain the same but the percentage of trust assets distributed would vary.
[3] 2018 value. This amount is subject to adjustment for inflation in future years.

Presented by Daryl Brockman

Lifetime Gifts

Lifetime gifts and transfers at death are taxed using a unified tax rate schedule that has cumulatively progressive rates. Each taxable transfer, including the final transfer at death, begins in the tax bracket attained by the prior gift.

Annual Gift Tax Exclusion

Each taxpayer is allowed to transfer/gift a certain amount of assets each year, without concern for gift taxes. This "annual exclusion amount" is currently $14,000[1] per donor and a gift of this amount can be given to each of any number of donees. If husband and wife agree, they can "split" gifts and give twice this amount, $28,000, to each of any number of children, grandchildren, etc.

Marital Deduction

There is an unlimited marital deduction for gifts of separate or community property passing from one spouse to another. Transfers to spouses who are not U.S. citizens are not protected by the gift tax marital deduction, but a non-citizen spouse is entitled to a special, annual gift tax exemption if such a gift would qualify for the marital deduction if the spouse were a U.S. citizen. For 2017, this special exemption amount is $149,000.

Educational or Medical Expenses

A donor may give, free of gift tax consequences, unlimited amounts for a donee’s school tuition (not books, supplies, or other expenses) or qualified medical expenses. Such gifts must be made directly to the school or health care provider, and not to the donee.

Deductibility for Income Tax Purposes

Gifts or gift taxes are not deductible for income tax purposes, unless contributed to a qualified charity.

Gift Tax Returns

These returns are filed annually, generally by April 15 of the year following the gift for amounts in excess of the annual gift tax exclusion.

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[1] 2017 value. This amount is subject to adjustment for inflation in future years.

Capital Gains and Losses

A donee generally takes over the basis of gifted property from the donor, known as "carry-over" basis. A later sale of gifted property by the donee can result in a capital gain, a capital loss, or a situation in which there is neither a gain nor a loss.

Includability of Gifts in the Estate

Gifts made within three years of death are not considered in the computation of the taxable estate. However, if they exceed the annual gift tax exclusion, they may be added to the taxable estate as adjusted taxable gifts. This, in effect, pushes the assets remaining in the taxable estate into the higher tax brackets; however, the appreciation on the assets from date of gift until date of death is not brought into the computation.

Gifts of life insurance policies, however, are still included if made within three years of death. Certain incomplete transfers (e.g., retained life estates, revocable transfers, etc.) will also be included in the gross estate without regard to when they were made.

All taxable transfers made within three years (except gifts that qualify for the annual gift tax exclusion) will be included for determining whether an estate qualifies for an IRC Sec. 303 stock redemption, the IRC Sec. 2032A special use valuation or the IRC Sec. 6166 deferral of estate tax payment.

Advantages of Making Gifts

- Gifts put future appreciation of assets out of the estate.
- The gift tax paid reduces the taxable estate.
- Making gifts of income-producing assets may reduce current income taxes.
- Probate administration is not necessary for gifted assets.
- The donor can see the beneficiaries enjoy the assets while he or she is still living.

Annual Exclusion Gifts

Reducing the Federal Estate Tax[1]

By following a consistent program of annual lifetime gifts to children, grandchildren, etc., an estate owner can dramatically reduce his or her taxable estate. The following chart illustrates the results of such a gifting program. It assumes that the gifts are made at the beginning of each year and will grow at 5.00% annually outside the donor's estate. In 2018, a person can give up to $15,000 per year to any number of people without incurring a gift tax.

Annual Gift	Number of Years Over Which Gifts Are Made				
	5 Years	10 Years	15 Years	20 Years	25 Years
$15,000	$87,029	$198,102	$339,862	$520,789	$751,702
30,000	174,057	396,204	679,725	1,041,578	1,503,404
45,000	261,086	594,305	1,019,587	1,562,366	2,255,105
60,000	348,115	792,407	1,359,450	2,083,155	3,006,807
75,000	435,143	990,509	1,699,312	2,603,944	3,758,509
90,000	522,172	1,188,611	2,039,174	3,124,733	4,510,211
105,000	609,201	1,386,713	2,379,037	3,645,521	5,261,913
120,000	696,230	1,584,814	2,718,899	4,166,310	6,013,614
135,000	783,258	1,782,916	3,058,761	4,687,099	6,765,316
150,000	870,287	1,981,018	3,398,624	5,207,888	7,517,018

______	x	______ %	=	______
Potential amount removed from estate (See chart above.)		Estimated top estate tax bracket (See below.)		Approximate savings which could pass to your heirs

Top Federal Estate Tax Brackets

Years	Top Bracket	Applicable Exclusion Amount[2]
2015	40%	5,430,000
2016	40%	5,450,000
2017	40%	5,490,000
2018	40%	$11,180,000

Note: If some of the annual gift amounts are used to purchase life insurance outside of the estate, the potential wealth-building effect becomes very dramatic.

[1] The discussion here concerns federal tax law. State or local law may differ.

[2] The "applicable exclusion amount" is the dollar amount of assets protected from federal estate tax.

Using the Applicable Exclusion Amount Today

Assets growing at about 5% per year will double in value in about 15 years. As the size of one's estate grows, so does the amount of estate tax which will one day come due.

Under federal law, only estates larger than the applicable exclusion[1] amount are subject to the federal estate tax. For 2018 the applicable exclusion amount is $11,180,000.

Rather than wait until death to make a gift, some taxpayers choose to make large, taxable lifetime gifts. The major benefit of this approach is that it can remove any future appreciation in the gifted assets from the donor's estate.

Consider the following example.

Assumptions:

Estate size: $20,000,000
Years until death: 15
Growth rate: 5%
Current gift amount: $11,180,000

	Assumes No Current Use of the Applicable Exclusion Amount	Assume a Current Gift of $11,180,000
Current estate size	$20,000,000	$20,000,000
Current gift	0	11,180,000
Balance in estate	$20,000,000	$8,820,000
Estate in 15 years at 5%	41,578,564	18,336,147
Add back gift at death	0	11,180,000
Taxable estate	$41,578,564	$29,516,147
Federal estate tax[2]	$10,611,426	$5,786,459
Potential tax savings	**$4,824,967**	

[1] The applicable exclusion amount is the dollar value of assets protected from federal estate tax by an individual's applicable credit amount.

[2] Calculated as though death occurs in 2033. The applicable exclusion amount ($11,180,000 in 2018) is assumed to inflate at 2.0% per year.