Easing the Estate Tax Burden

By
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One of the great joys of building wealth is the knowledge that your heirs may benefit for generations. But without proper planning during your lifetime, the federal government could tax as much as 40% currently of an estate upon death. There are strategies to lessen the burden, and putting them to use now will help ensure more of your assets will get to your heirs rather than be used to pay estate taxes.

The first step is to create a will that clearly expresses the estate holder's wishes and goals. It sets the road map for implementing the plan for the distribution of assets and helps protect the estate from undesired claimants.

To help you create an estate that enhances growth and helps reduce estate taxes, begin by putting a team of professionals together. That team should include an accountant, a lawyer and a financial advisor. Know what your goals are, then work with the team to create the correct foundation for your estate and reduce taxes within that plan.

Give the Family a Gift

One of the easiest ways to begin transferring wealth to the next generation is to enhance what the IRS calls the annual exclusion gift. In 2016, the IRS lets individuals give up to $14,000 a year to whomever they like without paying gift taxes. The annual gift exclusion means you can begin channeling your assets to your heirs tax free while lessening the value of the estate that may, upon death, be subject to taxation.

Individuals may make $14,000 annual gifts to as many people as they desire, including grandchildren or those outside their immediate family. For example, say an individual has a spouse, two children and four grandchildren. He could give $14,000 a year to each of his children and grandchildren, and his spouse could do the same – for a total of $28,000 per year to each, or $168,000 transferred between generations each year tax free.

For the benefit of funding an IRC Section 529 plan, you are allowed to currently use your annual exclusion gift for the next five years. Individuals can make a gift to one individual of $70,000 without paying gift taxes that year, but give up their right to make an additional gift for the following five years.

Taking five years at once might be a good option for funding a beneficiary's 529 college savings plan, which lets account holders put money into an investment account that has

tax-free growth potential as long as the proceeds are used to pay for qualified education expenses. Putting the maximum amount in early gives the fund more time to grow for the beneficiary.

Giving heirs the maximum amount allowed under the annual exclusion gift may not have a deep impact on those with large estates. It does, however, have the benefit of not counting against the federal government's lifetime giving credit, which lets people gift their heirs up to $5.45million. You may want to address the potential complexities of this tax credit with your financial advisor and how it can fit into your overall plan.

Give a Gift to Charity

Charitable giving should start with the desire to do good; it isn't wise to get involved with charitable giving just for tax credits and deductions. Nonetheless, used effectively, charitable trusts can be a win-win. They can ease the estate tax burden while also benefiting a worthy cause. Two variations on the charitable trust include the Charitable Lead Trust and the Charitable Remainder Trust.

With a Charitable Lead Trust, a donor funds a trust in which assets grow tax free while making scheduled annual payments to whatever charities the donor chooses. Once the gift is completed, the remaining assets go to whomever the donor designated – usually family members, either as a gift or put into a trust for their benefit. The donor may receive a current income tax deduction.

With a Charitable Remainder Trust (CRT), the donor funds the trust with appreciated assets and has an available income tax deduction. The CRT can sell the asset without recognition of capital gains and diversify upon the sale. The trust then provides income payments of at least 5% each year to the donor or another beneficiary, which are taxed either as capital gains or ordinary income, depending on the nature of the assets. When the term of the trust ends, the balance of the trust is then transferred to the philanthropic institution.

Put Your Life Insurance into a Trust

A Life Insurance Trust is a tool that further leverages the annual exclusion gift by shielding the life insurance proceeds from estate taxation. Generally, the trusts are formed to purchase a new life insurance policy. The policyholder then funds the trust with money or other assets to pay the premiums.

Officially, the trustee of the trust is both the policy holder and the beneficiary. Once you pass on, the trustee makes distributions according to your wishes as established within the trust document. If the trust is properly drafted, those distributions aren't counted as part of your estate, and are therefore not subject to estate taxes. One thing to keep in mind: Life Insurance Trusts are irrevocable, but with proper planning trust provisions

can accommodate changes in the future. Flexibility and coordination are the key components of a solid estate plan.

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