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Ten Tips for Year-End Estate and Tax Planning

by Robert Minnich and Leena Ketkar

Introduction

As 2015 winds down, now is the time to think about estate and tax planning. The following discussion provides an overview of the current law and 10 tips to help you maximize tax savings, including:

1. Current Laws

Pursuant to the Tax Relief Act, the applicable exclusion amount for federal gift and estate tax purposes is $5.43 million ($10.86 million for married individuals) for the remainder of 2015, and amounts transferred in excess of the applicable exclusion amount are subject to a 40 percent tax rate. The annual exclusion for gift tax remains at $14,000 for 2015. In addition, the generation-skipping transfer tax exemption amount is set at $5.43 million for 2015.

Absent intervening legislation before January 2016, the applicable exclusion amount for federal estate and gift tax purposes is indexed for inflation. In 2016, the applicable annual exclusion will rise to $5.45 million; however, the annual gift tax exclusion amount will remain the same, at $14,000.

2. Make Gifts!

Until the end of 2015, every individual can make an outright gift of up to $14,000 to an unlimited number of individuals, without incurring any gift tax consequences or dipping into the lifetime applicable exclusion amount. Married couples can jointly give up to $28,000 to an unlimited number of individuals.

3. IRA Direct Rollover to Charity

In December 2014, President Obama signed into law a tax code provision, effective for 2014 *only*, that allowed donors to make charitable gifts from their IRA without incurring income tax on withdrawals. The key requirements of this tax code provision were as follows: (1) the IRA holder must be at least 70.5 years old; (2) the distribution must be made directly from the IRA custodian to the qualified charity; (3) the gift cannot exceed $100,000; and (4) no goods or services can be received by the donor in exchange for the gift. This provision was recently permanently extended by Congress.

4. **529 Plan Contributions**
A 529 qualified tuition plan (or 529 Plan) is designed to encourage saving for future college costs. There are two different types of 529 Plans: prepaid tuition plans and college savings plans. The prepaid tuition plan allows beneficiaries to purchase credits at participating colleges and universities for future tuition; most plans are sponsored by state governments and have residency requirements. College savings plans allow for the creation of an account for the student for the purpose of paying the student's eligible college expenses. A college savings plan account holder is able to choose from many investment options, including stock, mutual funds, money market funds and age-based portfolios.

A 529 Plan allows income accumulated to not be subject to federal income tax, provided that the funds are used for qualified educational expenses. For a 529 Plan, there is no income, state residency or age restriction. Special rules allow a donor to contribute up to $70,000 into the 529 Plan without a reduction in the applicable gift tax exclusion in a single year. Furthermore, many states give full or partial state income tax deductions for contributions to the 529 Plan; Pennsylvania provides for a deduction of $14,000 per contribution.

5. **Grantor Retained Annuity Trusts (GRATs)/ Qualified Personal Residence Trusts (QPRTs)**
A grantor retained annuity trust, or GRAT, is an effective estate planning tool when interest rates are low and asset values are low. To create a GRAT, a grantor makes a gift to the GRAT in exchange for an annuity for a specific term of years. The value of the grantor's gift is equal to the value of the remainder interest in the GRAT when the GRAT is funded. The gift of the remainder interest should be as small as possible, so that the grantor uses the least amount of his or her applicable exclusion amount. After the term of years for the GRAT expires, leveraging of the applicable exclusion amount is realized once the appreciation of assets in the GRAT passes to the beneficiaries, free of any additional federal estate or gift tax. For a GRAT to be effective, the grantor must survive the term of the GRAT, or else the GRAT assets are included in the grantor's estate for federal estate tax purposes.

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Similar to GRATs are qualified personal residence trusts, or QPRTs, which may be an attractive option for individuals who have significant estates and a high-value residence or vacation home. A QPRT involves the individual/grantor transferring his or her personal residence or vacation home to the QPRT and retaining the right to live in the home for a fixed term of years. Upon the expiration of the term of years, the home passes outright to the remainder beneficiaries or is held in further trust for their benefit. The grantor may turn around and lease the property back from the remainder beneficiaries or the trust (as the case may be). QPRTs may be used in conjunction with other estate planning techniques, but are most appealing for individuals who might not have other high-value assets they are willing or able to gift at the time.

6. **Maximize Retirement Plan Contributions**
Be aware of the amounts that you may contribute to your employer-sponsored retirement plans and to individual retirement accounts. Contributing the maximum allowed is likely a smart move.

For 2015, the maximum that may be contributed to a 401(k), 403(b), 457(b) or a SARSEP is $18,000. Those taxpayers who turn 50 during the current tax year, or who are over age 50, may make an additional catch-up contribution of up to $6,000. In addition, your employer may contribute to your plan, depending on how much you contribute, so check with your employer's benefits coordinator for details.

The contribution limits for traditional IRAs and Roth IRAs are $5,500 for each. Similar to the retirement

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plans noted above, taxpayers who meet the 50 and older age limit may contribute an extra $1,000. With Roth IRAs, however, there are income restrictions, and for taxpayers with modified adjusted gross incomes of more than $116,000 for single tax filers, and more than $183,000 if married and filing jointly, the amount that may be contributed begins to decrease from the maximum allowed for taxpayers below those thresholds. Consult your tax adviser for further details regarding permitted IRA contributions if you believe that your modified adjusted gross income is over those thresholds.

You may also consider whether you want to convert your traditional IRA to a Roth IRA. Converting allows the tax-deferred growth that a traditional IRA provides to become tax-free growth. An additional advantage with a Roth IRA is that there are no required minimum distributions once the account holder reaches age 70.5. You may leave that account untouched as an asset that grows tax-free and leave it to your beneficiary through the account's beneficiary designation.

While there is an income limit when establishing a Roth IRA, there is no income limit for a holder of a traditional IRA to convert to a Roth. However, the converted amount is taxable during the year of conversion. Have your tax adviser run the numbers to see if this makes sense; be sure he or she takes into account your age and tax bracket, and whether you need the IRA funds during your retirement.

7. Flexible Spending Accounts (FSAs)

A Flexible Spending Account may be a great way to save for medical expenses and save on taxes at the same time. The funds contributed may be used for certain expenses related to health care or dependent care.

Many employers offer FSAs, which allow you to contribute money on a pretax basis, so it lowers the amount of income on which you are taxed. Employers set the account limits, but the IRS allows a maximum of $2,550 for an FSA and $5,000 for a dependent care FSA (for married couples filing jointly).

One disadvantage is that individuals with an FSA must use their funds saved in their accounts by a certain period of time — you must use it or you lose it. However, there is some flexibility on the deadline. Employers may offer a two-and-a-half-month extension for employees to incur and submit claims. There is also a new "carryover rule" that lets individuals carry over up to $500 of their unused FSA balance into the next year. Companies can choose to take advantage of one of these options, so check to see if your employer permits one of the two. Make yourself aware of what FSA plan options your employer provides, because there is much variation among employers.

8. Dynasty Trusts

A dynasty trust can be a powerful estate planning tool if you have a potentially large estate and you wish to minimize taxes. An individual, or grantor, establishes the dynasty trust and then gifts certain assets to the trust. The assets that are gifted to the trust are subject to federal gift tax and thus will use some or all of the grantor's available applicable exclusion amount. The assets and any appreciation thereon are then out of the grantor's estate for federal estate tax purposes. The grantor will also allocate some or all of his or her generation-skipping transfer tax exemption to the assets gifted to the trust, thereby forever sheltering growth from generation-skipping transfer tax.

In the trust instrument, the grantor can decide who the beneficiaries are and what rights they have. Usually, children are the primary beneficiaries, and after their deaths, grandchildren, and other further removed lineal descendants, become the trust beneficiaries.

9. Spousal Lifetime Access Trusts (SLATs)

A spousal lifetime access trust, or SLAT, allows couples to use their gift tax exemption while retaining access to the gifted property in the event they need it. Each spouse creates an irrevocable trust and contributes property with a fair market value up to his or her remaining gift tax exemption. Each spouse is the beneficiary of the trust created by the other spouse, and your descendants may be additional beneficiaries.

The trust property is not subject to federal estate tax upon the death of either spouse. Each spouse may also allocate his or her generation-skipping transfer tax exemption to the trust each creates, which will shelter the trust assets from transfer taxes at each generation.

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There are a few limitations. During a spouse's lifetime, there must be a prohibition on distributions that would satisfy his or her obligation to support the other spouse. Also, there needs to be adequate differences between the trust provisions of the two SLATs so that they are not deemed reciprocal trusts, which could result in the SLATs' assets included in the spouses' estates for estate tax purposes.

10. Irrevocable Life Insurance Trusts (ILITs)

Life insurance proceeds are part of a decedent's gross estate at the time of his or her death. One way to exclude those proceeds from a decedent's gross estate is for a grantor to create an irrevocable life insurance trust, or ILIT, to purchase and own the life insurance policy on the grantor's life.

If the ILIT purchases the policy, and the grantor did not have any incidents of ownership over the policy, the insurance proceeds are not part of the grantor's gross estate. If the ILIT does not purchase the policy, but instead the existing policy is transferred to the ILIT, the policy must be held by the ILIT for more than three years; otherwise, the insurance proceeds become part of the grantor's estate at the grantor's death.

During the grantor's lifetime, the grantor may make gifts to the ILIT. The trustee may then use the gifts to pay the premiums on the policy. If there are "Crummey" withdrawal powers in the trust instrument, the grantor may use his or her annual gift tax exclusion, which is currently $14,000 for an individual or $28,000 for a married couple, to preserve his or her applicable exclusion amount in making such contributions to the ILIT. Gifts in excess of the annual gift tax exclusion amount will use part of the grantor's $5.43 million applicable exclusion amount for federal gift tax purposes to offset any gift tax. At the grantor's death, the policy's death benefit will pass according to the trust provisions and will not be subject to federal estate tax.

Because of the $5.43 million applicable exclusion amount for federal gift tax purposes and the $5.43 million generation-skipping transfer tax exemption amount, individuals who are comfortable using their applicable exclusion amount currently have a significant opportunity to make large contributions upfront to an ILIT, free of federal gift and generation-skipping transfer tax.

Conclusion

The above-mentioned strategies are just some of the tools available to help you maximize your tax savings as the end of the year approaches. We look forward to hearing from you to discuss your estate planning goals and objectives, and to help determine which strategies might be appropriate for you, your family and/or your business.

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