

The Signalert Scoop

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Minimizing Estate Taxes By Gifting To Your Intended Heirs

Part I

**By Dr. Marvin Appel, President
Signalert Asset Management**

In the first decade of the new millennium, many Americans escaped the grip of estate and gift taxes as the government raised the amount of money you could leave without owing taxes. Now, if your property totals less than \$5.45 million you are not subject to federal estate taxes. (This number increases with inflation.)

However, there are fifteen states (and also the District of Columbia) that impose state-level estate taxes, many at lower limits than the federal. New Jersey is the least generous, exempting only the first \$675,000 from estate taxes. New York State taxes every dollar of your estate if it exceeds the threshold (currently \$4.1875 million).

Estate taxes can be very steep. The top federal estate tax rate is 40%, and if you live in New York State, you will have to pay a top 16% state tax rate on top of that. (The state tax is a deduction from the federal tax, so the combined top tax rate is 49.6%.)

Given tax rates this high, it can be useful to shrink your estate in ways that accomplish your legacy goals. One such strategy is gifting to charity, either in your will or before you die. Here, however, we will discuss making gifts to your intended heirs before you pass away.

Why lifetime gifting can reduce your estate tax burden

Compare two scenarios for someone who would be subject to the maximum federal estate tax rate. First, let's say she wants to bequeath \$1,000 (above the exemption amount). Her estate will have to have \$1,666.67: After subtracting the 40% estate tax bill from \$1,666.67, \$1,000 will remain for the heirs.

Suppose instead that this wealthy and generous person decided to give away \$1,000 while she still lives. There is no gift tax on the first \$14,000 that an individual gives to any recipient, so no tax would be due at all--the same \$1,666.67 in disposable cash would actually allow the intended heirs to get that full amount, rather than just \$1,000.

Let's suppose further that our generous benefactor has used up her \$14,000 gift tax exemption per recipient. Her heirs are still better off receiving the gift during the benefactor's lifetime: At the same 40% top federal gift tax rate, she were to give away \$1,000 she would also have to pay 40% of that amount, \$400, to the government. By giving while alive, she would be able to transfer the same \$1,000 for a total cost of \$1,400 rather than \$1,666.67. If she still wants to divest herself of the full \$1,666.67 then she can give away \$1,190.47 and pay a tax bill of \$476.19.

FAQ #1:

Q: What is included in the Estate?

A: The estate consists of an accounting of everything you own or have interests in at time of death.



The hardest thing in the world to understand is income tax.

- Albert Einstein



The reason for the difference is that there is no tax levied on funds you pay to the government as gift taxes. But your entire estate is taxed, even that fraction of it that is used to pay estate taxes.

Married couples can get double exemptions

If you are married, both you and your spouse have the same exemptions: Each of you can give \$14,000 per year to each recipient. Each of you can get a federal estate and/or gift tax exemption of \$5.45 million.

State tax laws likewise double the available exemptions for married couples. But you have to be careful, because in some ways state tax laws differ from the federal. For example, under federal law the first spouse to die can transfer his/her unused estate tax exemption to the surviving spouse. (This requires filing an estate tax return even if no tax is due.)

On the other hand, in New York State, spouses cannot transfer their unused exemptions. A couple with more than the current \$4.1875 million exemption amount who wants to minimize their state tax burden would have to title some assets in each spouse's name and could not leave their entire combined assets to the surviving spouse.



KEY POINTS

- **You only have to worry about paying federal estate or gift taxes if your net worth exceeds \$5.45 million each for you and your spouse.**
- **A number of states have lower exemptions. New Jersey is especially stingy with its exemption from estate taxes.**
- **You can reduce your estate tax burden by giving money to your intended heirs while you are still alive.**

What counts as a gift?

If you are not the parent or legal guardian of a child, paying room and board for that child's college counts as a gift and could be taxable. So could paying other expenses such as buying a car. On the other hand, paying for medical care or college tuition directly to the providers does not incur a gift tax liability. (Giving money to a child that is then used for college tuition does not escape the gift tax.)

Without significant financial aid, private college costs more each year than the annual gift tax exclusion. One way to get around paying gift taxes is to set up a 529 plan for the benefit of a future college student. Gifts to a 529 plan are treated the same as other gifts, but can be used for a variety of educational expenses, not just tuition. So, for example, you could contribute up to \$14,000 each year to your grandchild's 529 plan in the years before college and owe no gift tax. Then when your grandchild is in college, he can use the accumulated savings in the 529 plan to pay for room and board. In addition, you can pay the college tuition directly if needed. In this way, with advance planning you can pay the entire cost of your grandchild's college without owing any gift taxes.

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Signalert

Asset Management

Registered Investment Advisors

525 Northern Boulevard, Suite 210
Great Neck, New York 11021
516-829-6444

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For personalized investment management or financial planning, please contact us at:



Signalert Asset Management LLC

Email: clientservices@signalert.com

Web: www.signalert.com

From world renowned technician and inventor of MACD, Gerald Appel, and Dr. Marvin Appel, current editor:



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