Taxing Matters

Strategies for effective estate and tax planning

Christine Kolm, *Director*
Wealth Planning Strategies

Welcome to today's presentation

This presentation (including the PowerPoint and any written materials provided) has been prepared for you as an educational benefit. This information should not be relied upon by you as tax or legal advice. Examples included in this presentation are hypothetical and for illustrative purposes only.

You should always consult with your own attorney and/or tax advisor before making changes to your individual investment, financial plan and/or estate plan.

We will cover

1. Income tax planning
2. Estate tax planning considerations
3. Basic estate planning considerations
4. Questions

Income tax planning

Income tax overview

“New” taxes under Patient Protection and Affordable Care Act (2010):

- 0.9% Medicare tax on earned income exceeding $200,000 (single) and $250,000 (married)
- 3.8% Medicare tax on lesser of: net investment income or modified adjusted gross income in excess of $200,000/$250,000

Tax changes under American Taxpayer Relief Act of 2012:

- Top income tax bracket increased to 39.6% for income exceeding $413,200/$464,850 (indexed for inflation)
- Capital gains tax bracket increased to 20% for income exceeding $413,200/$464,850 (indexed for inflation)
- Personal exemptions and itemized deductions will be phased out for income that exceeds $258,250/$309,900
- AMT exemption expanded and indexed for inflation
- Qualified charitable rollover provision was extended to 12/31/14

Medicare tax on unearned income

Additional 3.8% tax on the lesser of:

- Taxpayer's **net investment income** for the tax year; or
- **Modified AGI (MAGI*)** in excess of:
  - **$200,000** if single
  - **$250,000** if married or surviving spouse

Single Taxpayer	Married Taxpayer	Net Investment Income Tax
$0 to $200,000	$0 to $250,000	None
$200,000 +	$250,000 +	**3.80%** (tax on lesser of net investment income or MAGI exceeding threshold

"Net investment income" includes interest, long-term capital gains, dividends, after-tax annuities, royalties, and rents – other than from trade or business.

It does not include distributions from a qualified plan or IRA.

***MAGI** is defined effectively as an individual's AGI increased by certain foreign earned income and housing costs.

Medicare tax on unearned income

Example: In 2015, Sally, single, has earned income of $175,000 and investment income of $40,000.

- Sally is subject to a 3.8% tax on $15,000 (MAGI in excess of $200,000)
- If she earns income in excess of $200,000, all of the investment income ($40,000) would be subject to a 3.8% tax

Itemized deduction phase-out rules reinstated

Itemized deductions will be reduced by 3% of AGI exceeding $258,250 (single) or $309,900 (married); up to 80% of itemized deductions.

Example: Jack and Jill have an AGI of $400,000 and have $75,000 of itemized deductions. Their itemized deductions will be reduced by $2,703 ([$400,000 - $309,900] x 3%).

- **Net effect:** More of Arthur and Emily’s income is subject to tax.
- Unreimbursed medical expenses, investment interest and casualty or theft loss will not be limited and will not be subject to the phase-out.

Single Taxpayer	Married Taxpayer
$258,250 +	$309,900 +

Itemized Deductions
Itemized deductions phased out by 3% of income exceeding threshold up to 80% of deductions

Personal exemptions phase-out rules reinstated

Personal exemptions will be phased-out by 2% for every $2,500 by which income exceeds $258,250 (single) or $309,900 (married).

Personal exemptions are completely phased-out at $380,750 (single) and $432,400 (married).

Example: Michael, single with income of $333,250, will "lose" the ability to claim 60% of his personal exemption ([$333,250 - $258,250 =$75,000]/$2,500 = 30 x 2%=60%). The personal exemption for 2015 is $4,000 ($4,000 x 60% = $2,400), so his allowable personal exemption will be $1,600 ($4,000 - $2,400).

- **Net effect:** More of Michael's income is subject to tax.

Single Taxpayer	Married Taxpayer
$258,250 +	$309,900 +

Personal Exemptions
Personal Exemptions phased out by 2% for every $2,500 exceeding threshold

Federal income tax brackets for 2015

2015 Federal Tax Rates (Single Taxpayers)	
10%	$0 - $9,225
15%	$9,225 - $37,450
25%	$37,450 - $90,750
28%	$90,750 - $189,300
33%	$189,300 - $411,500
35%	$411,500 - $413,200
39.6%	**> $413,200**

2015 Federal Tax Rates (Married Taxpayers)	
10%	$0 - $18,450
15%	$18,450 -- $74,900
25%	$74,900 - $151,200
28%	$151,200 - $230,450
33%	$230,450 - $411,500
35%	$411,500 - $464,850
39.6%	**>$464,850**

The above table references rates applied to taxable income, and does not reflect rates applied to capital gains, qualified dividends or the alternative minimum tax.

Capital gains and dividend taxes

- Short-term capital gains are taxed at ordinary income tax rates.
- These rates are in addition to the 3.8% net investment income tax imposed under the Affordable Care Act.

LT Capital Gains and Dividend Tax Rates	
Income Tax Bracket	**LT Capital Gains Dividend Tax Rates**
10%	0%
15%	
25%	15%
28%	
33%	
35%	
39.6%	**20%**

Income tax in 2015

<table>
<tr><th>Single Taxpayer</th><th>Married Taxpayer</th><th>Social Security Tax</th><th>Medicare Tax</th><th>Net Investme`nt Income Tax</th><th>Itemized Deductions</th><th>Personal Exemptions</th><th>Income Tax</th><th>Capital Gains Tax</th></tr>
<tr><td>$0 to $9,225</td><td>$0 to $18,450</td><td rowspan="9">6.2% on first $118,500 of income</td><td rowspan="5">1.45% on all income</td><td rowspan="5"></td><td rowspan="6"></td><td rowspan="6"></td><td>10%</td><td rowspan="2">0%</td></tr>
<tr><td>$9,225 to $37,450</td><td>$18,450 to $74,900</td><td>15%</td></tr>
<tr><td>$37,450 to $90,750</td><td>$74,900 to $151,200</td><td>25%</td><td rowspan="6">15%</td></tr>
<tr><td>$90,750 to $189,300</td><td>$151,200 to $230,450</td><td>28%</td></tr>
<tr><td>$189,300 to $200,000</td><td>$230,450 to $250,000</td><td rowspan="3">33%</td></tr>
<tr><td>$200,000 to $258,250</td><td>$250,000 to $309,900</td><td rowspan="4">2.35% (an additional 0.9% tax on income exceeding threshold)</td><td rowspan="4">3.8% net investment income tax on lesser of net investment income or MAGI exceeding threshold</td></tr>
<tr><td>$258,250 to $411,500</td><td>$309,900 to $411,500</td><td rowspan="3">Itemized deductions phased out by 3% of income exceeding threshold up to 80% of deductions</td><td rowspan="3">Personal Exemptions phased-out by 2% for every $2,500 exceeding threshold</td></tr>
<tr><td>$411,500 to $413,200</td><td>$411,500 to $464,850</td><td>35%</td></tr>
<tr><td>$413,200+</td><td>$464,850+</td><td>39.6%</td><td>20%</td></tr>
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Estate tax planning considerations

Estate tax overview

- Federal estate tax exemption set at $5,000,000 per taxpayer permanently
  - Indexed for inflation annually ($5,430,000 in 2015)
- Estate, gift and GST tax exemptions are equal
- Estate and gift tax rate is 40%
- Portability has been made permanent

“Portability” may help simplify

“Portability” allows married couples to combine federal estate tax exemptions

For couples whose combined federal taxable estates are less than $10.86 million, portability can

- Simplify planning (e.g., everything to surviving spouse)
- Provide greater flexibility for married couples with substantial retirement plan accumulations
- Alleviate the need to balance asset ownership between spouses

Formal election must be made to preserve deceased spouse’s unused exemption amount

On second thought…

- If the surviving spouse remarries, the “portable” amount may be impacted
- Credit Shelter Trust planning allows appreciation of trust property to avoid estate taxation
- Most states do not offer portability
- The Generation Skipping Tax exemption is not portable

Disclaimer planning may offer flexibility

- A “disclaimer” plan provides that assets pass to your surviving spouse.
- If your surviving spouse “disclaims,” the assets will pass to the next in line beneficiary under your estate plan
  - Can be your Credit Shelter Trust or non-spousal beneficiaries
- Rules for disclaimer:
  - Must be in writing, irrevocable and unqualified;
  - Made within nine months of when interest is created;
  - Must be made before receiving any benefit from the disclaimed asset; and
  - Disclaimed interest passes without any direction from the disclaiming party.

Now is a good time to review your estate plan

1. Do your planning documents reflect your wishes for the disposition of your assets?
2. Do the estate tax exemption amounts change how you should structure your estate plan?
3. What impact does “portability” have on your estate plan, if any?
4. Do you live in or own real property in a state that has a separate state or inheritance tax?
5. Is “disclaimer” planning an appropriate choice for your estate plan?

Basic estate planning considerations

If you were to become incapacitated…

What would happen to you?

- Where would you want to live?
- Who would take care of you?
  - Do your loved ones have the time or ability to help you?
  - Have you thought through the expenses of having to pay for assistance or care?

What would happen to your assets?

- Who would manage your assets?
- How would they be managed?
  - Do your loved ones have the financial acumen to handle your assets?
  - Would he or she know who to rely on?

Planning for incapacity – medical matters

Living Will or Healthcare Directive:

- Provides statement of intent for healthcare

Medical Power of Attorney (Health Care Proxy):

- Designate person(s) to make medical decisions if you are incapacitated
- Authorize person(s) to have access to protected medical records under HIPAA

Accessibility:

- Make sure your agents have copies of your Living Will and Health Care Proxy and that they know where the originals are stored
- Originals should be kept someplace safe yet accessible – such as a safety deposit box or with your attorney

Planning for incapacity – money matters

Durable Power of Attorney for financial purposes:

- Authorize someone to handle your financial affairs if you are disabled
- Agent can act in the manner authorized with respect to assets specified
- May become effective immediately or upon a triggering event
- Avoids legal proceedings
- Consider the following powers:
  - Power to make gifts
  - Power to change beneficiary designations
  - Power to transfer assets to trust

Planning for incapacity – money matters

Revocable Trust:

– Commonly provides for the disposition of assets both during lifetime and at death

– A successor trustee can be named to step in and continue to manage assets for the Grantor’s benefit following the Grantor’s incapacity

– Only assets that are owned by the trust will be subject to the trustee’s management

- A Durable Power of Attorney may allow your agent to transfer assets to your Revocable Trust

Things to consider before your death….

Things to think through before visiting an attorney:

- Who do you want to inherit your assets? How do you want them to inherit assets? When do you want them to inherit your assets?
- Can your beneficiary responsibly manage an inheritance?
- Are you concerned with your beneficiaries spending habits?
- How important is tax minimization to you?
- Who is going to administer your estate plan?

The type of planning that you implement will depend on your ultimate goals with respect to your beneficiaries.

Documents everyone should consider

Last Will and Testament:

- Directs distribution of your assets upon your death
- Common elements:
  - Name a personal representative or executor
  - Nominate a guardian for minor children
  - Consider how your beneficiaries receive your property – outright or in trust
- Include federal and state tax planning provisions
- If you do not have a Will, your estate will be subject to intestacy
- Assets passing by Will are subject to probate
- State-specific rules as to creation and execution

Documents everyone should consider

Revocable Trust:

– Commonly provides for the disposition of assets both during lifetime and at death

– Provides continuity of management

– When properly funded, avoids probate

– State-specific rules as to creation and execution

– Common elements:

  - The parties – Grantor, Trustee, and Beneficiary
  - Can be amended or revoked during lifetime

Estate tax planning

Should tax planning be part of your estate plan?

- If your taxable estate exceeds the estate tax exemption, you should consider tax planning
  - In 2015, the federal estate tax exemption is $5,430,000
  - In addition to federal estate tax, your state may impose a separate estate or inheritance tax
  - You should consider not only the current value of your estate, but any anticipated growth in your estate
  - Also consider your beneficiary's tax situation

Questions

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