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Money / Financial Planning

I'm a Financial Advisor: What Boomers Need To Know About Estate Planning

S MIN READ

January 15, 2024 | By Sean Bryani



As baby boomers begin to retire and transition into the next phase of their lives, many are realizing the importance of estate planning and being able to minimize inheritance taxes.

Because they are now on the giving end of the great wealth transfer, it has become essential for boomers to know how to manage their assets and protect their legacies efficiently.

Keep reading to find out how taxes can impact <u>estate planning</u> and discover ways to minimize them.

How Taxes Impact Estate Planning

A few types of federal and state taxes come into play with estate planning. Federal estate taxes can reach up to 40%, so it is important to understand how taxes will impact your assets and your heirs.

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An estate tax is a tax on the transfer of your taxable assets, which includes things such as cash, securities and other property. Estate tax only kicks in if the value of your taxable estate exceeds the federal exemption limit, which is \$13.61 million for the 2024 tax year. Assets inherited by your spouse, if a U.S. citizen, are not subject to estate tax.

A gift tax is levied when transferring money or property to another person while receiving nothing or less than full value in return. The gift tax rate ranges from 18% to 40% and the gift-giver generally pays the tax. If your lifetime gifts, including your estate, exceed the federal exemption amount, — \$18,000 for 2024 — you could be subject to a gift tax.

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States also have their own estate and gift taxes. Some states have an inheritance tax paid by the beneficiary who inherited assets upon someone's death. While an inheritance isn't considered income for federal taxes, it may be considered taxable income by some states, and state inheritance tax rates can range from 1% to 18%.

Tips for Minimizing Your Inheritance Taxes

Your heirs will likely face large inheritance taxes if you have a large estate. Fortunately, there are ways to minimize your estate tax burden.

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Give During Your Lifetime

Gifting assets during your lifetime can reduce the overall value of your taxable estate. Instead of leaving your heirs with 100% of your assets after your death, you could gift them while still alive.

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There is an annual exclusion amount for gifts you can give before triggering gift taxes. In 2024, the exclusion will be \$18,000 per recipient per year, which is an increase from \$17,000 in 2023. For a married couple, it would be \$36,000.

"Consider gifting assets that are expected to appreciate in value, as this will move any future appreciation out of the taxable estate," said Achim Neumann, the founder of <u>A Neumann & Associates</u>.

Neumann explained, "Payments for medical expenses and tuition fees do not count against the annual exclusion if paid directly to the institution."

So, you can pay for an heir's medical bills or tuition without being subject to taxes as long as the payments are made directly to the school or medical facility.

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Another option is to give to charity or a 501(c)3 organization.

Establish Irrevocable Trusts

An irrevocable trust is one that the creator can't change or revoke after the assets are in the trust. Irrevocable trusts can minimize future estate taxes and help avoid the probate process upon death.

There are several types of irrevocable trusts that work in slightly different ways.

Grantor retained annuity trusts and spousal lifetime access trusts allow you to move highly appreciated assets out of your estate.

Intentionally defective grantor trusts allow the granter or owner of the trust to pay for any income tax owed on assets housed within the trust.

Irrevocable life insurance trusts can own a life insurance policy so that your heirs can use policy proceeds for estate taxes.

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Once irrevocable trusts are executed, making changes to that trust is very difficult, so be certain about this strategy before going this route.

As Neumann explained, "Irrevocable trusts can be particularly beneficial for tax purposes. Once the grantor places assets into an irrevocable trust, they are no longer considered part of the estate, thus not subject to estate taxes."

Utilize the Spousal Exemption

Assets inherited by your spouse, if a U.S. citizen, are not subject to federal estate taxes. Gifts to your spouse, if they are U.S. citizens, are also excluded from the gift tax.

Consult Professionals

Everyone's financial circumstances are a little different, and estate planning is complex, especially when trying to minimize tax liability. Working with an estate planning professional can help you further optimize your transfer of wealth and minimize taxes.

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The Bottom Line

If you are passing your assets onto an heir, you likely want as much of that to actually go to your heir instead of to the IRS. Understanding estate planning and inheritance taxes is the first step toward establishing a better financial future for your heirs.

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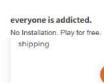


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